No. 88-940

Supreme Court, U.S.
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In The Supreme Court of the United States October Term, 1988

BANK ONE, STEVENS POINT, NA,

Petitioner,

v.

UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, C. WILLIAM VERITY in his official capacity as Secretary of Commerce, UNITED STATES OF AMERICA, REMER HUTCHINSON, and ELAINE HUTCHINSON,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. May the federal government escape liability on its guarantees to a lender pursuant to a federally-guaranteed high-risk loan program where the federal officials authorized to administer the federal guaranty program knew of, participated in and approved the very practices and decisions upon which the federal government now relies to renege on its guaranty obligations?
2. May a court of appeals make findings of fact?
3. Did the court of appeals properly apply the doctrine of pendent-party jurisdiction when it vacated a final, litigated judgment and ordered the pendent parties dismissed, even though the claim related to them arose out of the same financial transaction and the requirements of the same government loan program as the claim related to the federal government?

LIST OF PARTIES

The parties to the proceedings below include the petitioner Citizens Marine National Bank*- and the respondents United States Department of Commerce, Economic Development Administration, C. William Verity, in his official capacity as Secretary of Commerce, United States of America, Remer Hutchinson and Elaine Hutchinson.

Other parties involved below include Weber Tackle Company and Weber Plastics, Inc. These parties stipulated to a judgment of foreclosure and replevin in favor of the petitioner before trial, were not involved in the appeal to the Seventh Circuit, and are not before this Court.

- *Petitioner Citizens Marine National Bank has changed its name since the inception of this litigation and is now known as BANK ONE, STEVENS POINT, NA. Petitioner's parent company during this litigation became The Marine Corporation. The Marine Corporation has since been acquired by BANC ONE CORPORATION.

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In The
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CITIZENS MARINE NATIONAL BANK, formerly the Citizens National Bank of Stevens Point,

Petitioner,

v.

UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, C. WILLIAM VERITY in his official capacity as Secretary of Commerce, UNITED STATES OF AMERICA, REMER HUTCHINSON, and ELAINE HUTCHINSON,

Respondents.

Petitioner, Citizens Marine National Bank, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this case on August 8, 1988.

OPINIONS BELOW

The memorandum decision of the United States District Court for the Western District of Wisconsin (Shabaz, D.J.) has not been reported. It is printed in the appendix at A.13.[1] The district court's opinion expressly incorporated the parties' stipulated findings of fact which are also included in the appendix, A.21. The district court's

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[1] Citations to "A." are to the Appendix accompanying this petition. Citations to "Ex." are to the trial exhibits and "R." to the docket sheet entries of record.

memorandum and order granting the motion for summary judgment of Citizens Marine National Bank against Remer and Elaine Hutchinson is not reported and is printed in the appendix, A.61. The opinion of the United States Court of Appeals for the Seventh Circuit is reported at 854 F.2d 223, and is printed in the appendix, A.1.

JURISDICTION

The jurisdiction of the United States District Court for the Western District of Wisconsin was invoked under 19 U.S.C. § 2350 because this case involves a controversy arising from the government's provision of financial assistance under the Trade Act of 1974, 19 U.S.C. § 2341 *et seq.* The final judgment of the district court was entered on October 8, 1987. A.70. The judgment of the United States Court of Appeals for the Seventh Circuit was entered on August 8, 1988. A timely petition for rehearing with suggestion for rehearing *in banc* was denied on September 9, 1988. A.75. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The following provisions of the Trade Act of 1974 are set forth in full in the appendix, A.76-78:

1) 19 U.S.C. § 2342(b) (1982) Approval of Adjustment Proposals: Technical and Financial Assistance;

2) 19 U.S.C. § 2344(a) (1982) Financial Assistance: Direct Loans and Guarantees of Loans;

3) 19 U.S.C. § 2345(a) and (e) (1982) Conditions for Financial Assistance: Unavailability of Firm's Resources; Reasonable Assurance of Repayment and Loan Guarantee Conditions;

4) 19 U.S.C. § 2347(a)(5) (1982) Administration of Financial Assistance: Powers of Secretary;

5) 19 U.S.C. § 2350 (1982) Civil Actions.

STATEMENT

In 1981 petitioner, Citizens Marine National Bank ("Citizens"), a small, independent community bank in central Wisconsin, was induced to make two loans, totalling $2.1 million, to Weber Tackle Company and Weber Plastics, Inc. ("Weber"), by the federal government's promise to guarantee 90% of those loans pursuant to the Trade Act of 1974 ("Trade Act"), 19 U.S.C. 2341 *et seq.* Exs. 2-5. Weber was a distressed fishing tackle manufacturer and significant employer located in central Wisconsin. Ex. 1. When Weber was unable to repay the loans, Citizens turned to the government as guarantor. The government refused to honor its guarantees, resulting in this litigation.

A. The Federal Guaranty Program Pursuant To The Trade Act Of 1974.

Under the Trade Act, the Secretary of Commerce was authorized, through the Economic Development Administration ("EDA"), to make and guarantee high-risk loans, that financial institutions would not otherwise make, to businesses severely and adversely affected by imports.

In order to obtain Trade Adjustment Assistance, an affected business was required to provide a "reasonable assurance of repayment" of the loan. 19 U.S.C. § 2345 (a) (2) (1982); 13 C.F.R. § 315.56 (a) (3) (1988); A.52. The Senate report accompanying the bill recognized, however,

> that the adjustment assistance loan program will deal with firms that have been weakened by import competition. In this regard the *term 'reasonable assurance of repayment,' which refers to both direct and guaranteed loans, should not be taken to mean reasonable assurance of repayment in the strict banking or commercial sense because adjustment assistance loans are admittedly high risk loans.*

S. Rep. No. 1298, 93rd Cong., 2d Sess. 149 (1974) (emphasis added). As in other federal high-risk credit programs, the

EDA was considered "the bank of last resort." R.196. In order to receive a federal guaranty under the Trade Act, a company was required to demonstrate that it could not get financial assistance from *any* private bank or financial institution *without* the federal guaranty.[2]

B. The Guarantees to Citizens.

During 1979, Weber approached Citizens and requested working capital and fixed asset loans for use in financing Weber's operations and for modernization. Citizens, as well as other area banks, determined that they would not lend Weber the requested funds because of Weber's unsatisfactory credit history and large debt. A.23. Weber then commenced the certification and application process for federal assistance under the Trade Act. A.23-24. From that moment on, the EDA controlled and actively participated in Weber's Trade Adjustment Assistance transaction.[3]

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[2] Approximately 77% of those companies that actually received federal assistance under the Trade Adjustment Assistance program failed to recover. *See* U.S. Dept. of Commerce, Office of Inspector General, Rep. No. D-068-5-006, *International Trade Administration Trade Adjustment Assistance: No Cure For Import-Injured Firms,* (March 1985). A House committee concluded that the program had "been administered arbitrarily over the years, creating uncertainty and unfairness." H.R. Rep. No. 241, 99th Cong., 1st Sess. 190 (1985).

[3] The EDA exercised significant control over and maintained active participation in the servicing and monitoring of the entire Weber transaction in, among other things, the following respects:

-It controlled Weber's application for federal assistance (A.23-31; Exs. 1, 29-36, 44-52, 72-77);
-commissioned business and financial experts to prepare a "Recovery Plan" for Weber (A.24-28);
-independently reviewed and determined that Weber's Recovery Plan was viable and acceptable (A.27-29);
-attended and controlled the closing (A.32);

Continued

The EDA, and not Citizens, commissioned financial experts, at the government's expense, to develop a "Diagnostic Analysis and Recovery Plan" ("Recovery Plan") for Weber as required under the Trade Act.[4] The EDA's Acting Deputy Assistant Secretary for Finance wrote to its Regional Director that the EDA was aware of Weber's "precarious" financial position and that Weber was in desperate need of a "miraculous recovery." Ex. 37. Nevertheless, the EDA determined the proposed final Recovery

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[3] *Continued from previous page*

-authorized initial disbursements to Weber (A.32);
-required and approved the procedures for the disbursement of the loan proceeds (A.33-34; R. 228: 42-53, 98; Ex. 76);
-imposed numerous reporting and other requirements on Citizens and Weber (A.32, 35-37; Exs. 2-5, 10-16, 73, 76, 77, 81-86, 92, 111-117, 119-139, 154, 156-160, 168, 170-172, 178, 179, 181-189);
-denied a merger of Weber with another company (Exs. 82-83);
-denied a modification request to shift unneeded fixed asset funds to working capital (A.38; Ex. 118);
-denied a modification request to amend allowable fixed asset uses in accordance with Weber's changing needs (A.38-40; Ex. 95);
-considered options to enable Weber to work its way out of default (A.37-40);
-performed an updated analysis of Weber's Recovery Plan and determined that the Recovery Plan remained viable even after Weber's default (Ex. 94); and
-authorized Citizens to accelerate the loan and to make demand on the guarantors. (Ex. 162).

[4] The proposed final Recovery Plan was submitted to the EDA by Weber and the Midwest Trade Adjustment Assistance Center, a federally sponsored entity comprised of business and financial experts. Ex. 1. The EDA reviewed the Recovery Plan to ensure that it contained all the information the EDA needed in order to evaluate Weber's application, including but not limited to. the required findings set forth in the Trade Act. A.27-28, 49-60.

Plan was viable and acceptable after an independent EDA review prior to closing. A.24-29; Ex. 1.[5]

The EDA then offered to enter into Trade Adjustment Assistance loan guarantees with Citizens in order to induce Citizens to make the loans to Weber. R. 74, 107, 182. As a necessary component of the transaction, the EDA required that the Small Business Administration ("SBA") subordinate its interest in certain of Weber's collateral to the EDA. This collateral secured an existing SBA guaranty made pursuant to the SBA loan program. The EDA further required that Citizens obtain a personal guaranty from Remer and Elaine Hutchinson, who were the owners and principal officers of Weber. Exs. 2-5.

Prior to closing, the EDA received all of the information it had requested from Citizens, *including* Weber's audited financial statements for the fiscal year ending July 31, 1981.[6] A.87; Ex. 51. The 1981 financial statements showed that Weber was behind in the financial projections

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[5] The EDA also performed a specific analysis to determine whether Citizens would be in a better, or more secure position after the Trade Adjustment Assistance guaranteed loans were made, than before. R. 188:5; Exs. 37, 50. The EDA determined that Citizens was less, or equally, secured after the federal loan guarantees were issued as compared to Citizens' pre-guaranty position. This finding was required prior to EDA's approval of the guarantees. Ex. 37; R. 188.

[6] The EDA did not express any criticism concerning Weber's 1981 financial statements or the closing of the loans in any of its pleadings before the district court and never expressed any concern about the financial statements or the closing until the time of trial. The district court did not specifically determine that the EDA had obtained Weber's 1981 financial statements prior to closing. However, the stipulated exhibits show that the EDA had received the statements prior to closing (A.87, 88; Exs. 51, 68), and the EDA acknowledged on appeal that it had done so, as the court of appeals recognized. A.10.

contained in the Recovery Plan.[7] The accounting firm responsible for preparing Weber's 1981 financial statements *wrote directly to the EDA* and specifically drew attention to Weber's continuing financial troubles:

> Although the statements were prepared in conformity with generally accepted accounting principles, we were required to qualify our opinion because of the uncertainty of the Company's ability to increase its sales volume in accordance with its recovery plan, which the company must do to remain a viable entity.

A.88; Ex.68.

Under the guaranty program, the government, and not Citizens, was responsible for determining whether the loans would be closed and the guarantees made. Exs. 2-5, 14, 76, 109. On December 17, 1981, the loans were closed and the guaranty agreements became effective. A.32, 90; Ex.14. An EDA financial analyst and loan officer, together with EDA's legal counsel, were present at the closing. A.32. They verified that all of the requirements on EDA's extensive closing checklist were met. Ex. 76.

The guaranty agreements expressly provided that Citizens "shall not make first disbursement" on the loans until the Regional Director of the EDA provided written notice that, "in the opinion of the Regional Director," there had been no unremedied adverse changes in the financial condition of Weber sufficiently serious to warrant withholding disbursements. Exs. 3, 5. Immediately following the closing, the Regional Director of the EDA, with specific delegation of authority from the Assistant Secretary of Commerce (A.82; Ex. 7), confirmed in writing that all program requirements for closing had been accomplished

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[7] Weber had fallen behind the Recovery Plan financial projections due in part to the long certification and application process required for obtaining Trade Adjustment Assistance.

and *authorized* Citizens to disburse proceeds. The Regional Director also *certified* that as of December 17, 1981, seven days after the EDA had received Weber's 1981 financial statements and after the EDA had received direct communication from Weber's accounting firm, there had been no unremedied adverse change in the financial condition of Weber sufficiently serious to warrant withholding disbursements on the loans. A.82, 88, 90; Exs. 7, 14, 68. Citizens then disbursed the funds.[8]

Throughout the process, the EDA specifically instructed Citizens to deal directly with certain EDA officials for the purposes of sharing information, resolving questions as they arose and obtaining required approvals and recommendations. A.85; Exs. 9, 73, 83, 86, 98, 110, 118, 161. Citizens and EDA officials were in continuous contact both before and after the closing of the Weber loans and guaranty agreements.[9] A.35. At all times, the EDA knew of Weber's financial condition and maintained an ongoing awareness of Citizens' actions.

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[8] The guaranty agreements required Citizens to disburse, service, collect and liquidate the loans as a prudent lender would in dealing with a loan of its funds without a guaranty. This obligation, however, related only to Citizens' actions *subsequent* to closing and *subsequent* to initial disbursements of the loans. Ex. 3, 5.

[9] Citizens received and sent to the EDA monthly financial statements from Weber from 1981 through the time Weber ceased operations, as well as annual audited statements prepared by accounting firms retained by Weber. A.35-36. The EDA financial analysts then reviewed them for compliance with the guaranty agreements. A.36. Citizens also provided the EDA with the required EDA quarterly report identified as "ED-700" forms. These reports provided the EDA with information regarding the status of the Weber loans, including the amount of advances made for each loan during the prior quarter. A.36. In addition, Citizens sent to the EDA periodic financial reports and projections on Weber's operations. R. 228.

C. Weber's Default and the EDA's, SBA's and Citizens' Joint Efforts at Work-Out.

Weber defaulted on the EDA guaranteed loans on October 18, 1982. A.36. After default, Citizens continuously communicated with the EDA regarding the status of the transaction, including Weber's default, loan advances considered appropriate after default and Weber's unremedied violation of certain negative convenants contained in the loan agreements. A.36-38. In reliance on the government's guarantees, Citizens refrained from proceeding to immediately liquidate the Weber collateral but rather followed instructions from EDA officials in Washington D.C. and Chicago to continue to work with Weber and the EDA in efforts to rehabilitate Weber and maintain employment in the community. A.42-43.

In September, 1983, nearly a year after Weber's default, the EDA performed an updated analysis of the financial position of Weber, as well as an evaluation of the prospects for improvement in Weber's financial condition. An EDA financial analyst made a field visit to Weber and submitted a report of his findings. Ex. 94. This report concluded:

> [S]ince the Recovery Plan was prepared in 1979 and 1980, Weber's needs have changed. *The overall project has not changed and the Recovery Plan is still valid.* . . . A field visit was conducted with the Lender and Weber on September 8, 1983. It was *confirmed that the Lender is closely monitoring Weber's operations and is servicing the loan as a prudent lender.*

Ex. 94. (emphasis added). All circumstances about which the EDA would subsequently complain, existed and were known by the EDA prior to this visit and report.

On June 15, 1984, Citizens finally requested that the EDA honor its guaranty commitments and repurchase the 90% guaranteed portion of the loans. A.41. Citizens also demanded that the SBA honor its guaranty obligations

to Citizens on the previous SBA-guaranteed loan to Weber made under similar conditions. Ex. 149.

The SBA promptly honored its guaranty. R. 200; Ex. 152. On February 21, 1985, the EDA Director of Liquidation in Washington D.C. wrote Citizens to schedule a closing for EDA's payment on its guarantees. A.91; Ex. 193. Then, a year later, the EDA for the first time refused to acknowledge liability on its guaranty agreements by a letter dated February 20, 1986, offering no explanation except that the "EDA has determined that the Bank has not complied with all of the provisions" of the guaranty agreements. Ex. 197.

D. Proceedings Below.

Citizens had filed a state court action against Weber on June 12, 1985, prior to the EDA's refusal to pay on its guarantees, seeking to foreclose on Weber's collateral securing the Trade Adjustment Assistance loans. After Weber asserted a third-party complaint against the SBA and the EDA, the government removed the case to the United States District Court for the Western District of Wisconsin. Citizens thereafter amended the complaint to add claims against the government based upon the EDA's announced dishonor of its guaranty obligations to Citizens.[10]

The jurisdiction of the district court over Citizens' claims against the government was premised upon 19 U.S.C. § 2350, which waives sovereign immunity and empowers the Secretary of Commerce to sue or be sued, for any amount of money, with respect to claims arising from the Trade Act. A.78. Citizens also asserted a claim against Remer and Elaine Hutchinson based upon their personal guaranty. The Hutchinsons asserted a claim

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[10] Weber's third-party complaint against the government was dismissed and, ultimately, Citizens and Weber entered into a stipulation for entry of a judgment of foreclosure and replevin against Weber. R. 137, 154, 164, 292.

against both the government and Citizens relating to the EDA's interest in the collateral arising out of the guaranty loan transactions.

The government answered Citizens' complaint alleging a laundry list of facts and defenses, most of which were later abandoned or stipulated away as a result of Citizens' discovery efforts. The government specifically alleged that Citizens acted imprudently, and without the EDA's knowledge or awareness, in its disbursement procedures for the fixed asset loan, in making fixed asset disbursements after Weber's default, and in covering certain of Weber's overdrafts. R. 34, 36, 46. The government ultimately relied at trial solely upon its allegation that Citizens had failed to act as a reasonable and prudent commercial lender would act in dealing with a non-guaranteed loan. It argued, though primarily on appeal, that closing the Trade Adjustment Assistance loans after receipt of Weber's 1981 financial statements was the most significant and serious reason for releasing the government on its guaranty obligations to Citizens.

1. The District Court's Findings.

The essential facts were stipulated and adopted by the district court. A.21-60. The stipulations confirmed in detail the decisions made by the EDA and the EDA's knowledge of the actions taken by Weber and Citizens concerning the transaction.

The district court determined that the government's allegations of Citizens' imprudent practices did not release the government from its guaranty obligations because: (1) the federal program requires "imprudent," high-risk loans, as the government was fully aware (R. 235); (2) the government had proceeded with complete and ongoing knowledge and awareness of the very circumstances, actions and practices it was attempting to rely upon to avoid its guaranty obligations; and (3) neither the government nor its federal assistance program had been harmed

by any of Citizens' actions. A.17-20. The district court found that Citizens

> was indeed administering [the loans] with the approval and with the understanding of the EDA, who is now attempting to renege on its commitment.

R.235.

The district court also specifically found: (1) that the EDA had condoned Citizens' loan disbursement procedures; (2) that the EDA knew of the post-default disbursements and did not complain or protest; and (3) that the EDA had presented no evidence of harm resulting from its other allegations of imprudence. A.17-20. The district court concluded that the totality of these circumstances showed that "there has been no substantial and material breach of duty by" Citizens, and that the "government cannot now be heard to complain when it has only itself to blame for the losses which have occurred." A.20.

The district court also granted Citizens' motion for summary judgment against the Hutchinsons on their personal guaranty and granted the government's and Citizens' motions for summary judgment against the Hutchinsons on the Hutchinsons' claims concerning the collateral. A.61.

2. The Court of Appeals' Reversal.

On the government's appeal, the United States Court of Appeals for the Seventh Circuit, in a decision authored by Judge Posner, reversed the district court. The panel swept aside as "clearly erroneous" the district court's factual determination that no material breach by Citizens of its guaranty obligations had occurred, after passing quickly over this "vital question." A.9. The panel then proceeded to announce its own findings of fact.

The court of appeals found that the Trade Adjustment Assistance transaction had become "too risky" before the closing in light of Weber's 1981 financial statements. A.9.

The panel stated that Citizens' practices after closing "were less important," but that the "cumulative picture" was one of material breach, voiding the guaranty. A.10. The court of appeals also found, by jettisoning the district court's findings and creating its own, that the EDA officials did not have actual or apparent authority to bind the government, and further that the traditional elements of estoppel were not present because, it said, "there were no promises, misrepresentations, or misleading silences, and there was no reliance by the bank." A.11.

The court of appeals reversed the district court despite acknowledging that

> [t]he government had received a copy of Weber's 1981 financial statement before the loan closed, and could have withdrawn from the deal, but didn't. And the employees of the Economic Development Administration who supervised the transaction with the bank became aware of many of the bank's imprudent practices yet turned a blind eye. . . . The Trade Act of 1974 authorizes the government to make risky loans (or loan guarantees)–indeed, *requires* that they be risky, since a condition precedent is that the borrower be unable to obtain financing on ordinary terms in the private capital markets.

A.10-11 (emphasis in original).

The appellate panel also vacated *sua sponte* Citizens' judgment against the Hutchinsons on grounds that the district court lacked pendent-party jurisdiction over the Hutchinsons, a doctrine as to which it said "no generalization is possible." A.6-7, 11, 73.

Citizens timely petitioned for a rehearing with suggestion for rehearing *in banc* on August 22, 1988, which was denied by order dated September 9, 1988. A.75.

REASONS FOR GRANTING THE WRIT

This Court should review whether the federal government can escape liability on its guarantees pursuant to high-risk federal loan programs despite federal officials' actions, knowledge and decisions, for the following reasons.

First, this case presents a recurrent and fundamental question that this Court has expressly left undecided in past decisions, and as to which the circuits have applied different standards. This Court has never clarified the parameters of the federal government's responsibility and liability for the actions and knowledge of federal officials in their direct and authorized capacity as financial intermediaries with private citizens. As acknowledged by the court of appeals "[t]he question whether and in what circumstances the federal government can be estopped by an act of its agents remains unsettled. . . ." A.11. Participants in federal credit programs need guidance.

Second, this issue is of enormous import because of the large number and amount of financial transactions entered into pursuant to federal credit programs. Federal credit programs collectively make the federal government the largest financial intermediary in the nation, and directly or indirectly influence the allocation of $1.3 trillion of outstanding credit to farmers, homeowners, businesses, exporters, utilities, ship builders, and state, local and foreign governments.[11] These federal credit programs offer credit to borrowers for whom no private source of credit is

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[11] *See* U.S. Office of Management and Budget, *Special Analyses: Budget of the United States Government, Fiscal Year 1989; Special Analysis F: Federal Credit Programs,* F-1-F-94, (1988).

available, making the government the "bank of last resort" for such borrowers.[12]

The court of appeals' decision jeopardizes the integrity and undermines the continued functioning of all federal loan guaranty programs. During the pendency of this litigation, a number of other cases involving EDA guaranteed loans have been winding their way through the courts around the country, and we have been informed by counsel in at least one of those cases that EDA officials are thrusting the court of appeals' decision in the faces of financial institutions. Under the doctrine of this case, no financial institution will feel safe to enter into loans under these guaranty programs, and consequently the programs themselves will fail. While the Seventh Circuit might very well consider such a result sound economics, it is contrary to the determinations made by Congress, the branch of government entrusted with those judgments.

Third, the court of appeals' decision is in direct conflict with at least two significant principles declared by this Court: (1) When Congress places a government agency into the commercial world by virtue of, *inter alia,* waiving sovereign immunity and permitting the agency to sue or be sued, there is a presumption that the agency's liability is the same as that of any other business, *Loeffler v. Frank*, 108 S. Ct. 1965 (1988); *Franchise Tax Board v. United States Postal Service,* 467 U.S. 512, 520 (1984); and (2) Members of the public have a legitimate expectation of some minimum standard of decency, honor, and reliability in their dealings with their government. *Heckler v. Commun-*

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[12] *Id.* There are over 30 specific federal direct loan programs, and more than 20 guaranteed loan programs. A listing of these programs is set forth in the appendix at A.79. Although the federal agency involved here has had its responsibilities for the Trade Adjustment Assistance program reduced, the question presented has ongoing and recurring significance because it involves the extent to which borrowers and private lenders can have trust and confidence in the representations and actions of the federal officials with whom they are instructed to work in connection with federal credit programs.

ity Health Services of Crawford County, Inc., 467 U.S. 51, 60-61 (1984).

The fundamental unfairness of the decision below is reflected in the Catch-22 it creates: under a program like the one here, the government will induce a lender to make a loan only if the lender first refuses to make the loan without the government guaranty because of the loan's high risk; yet the government need not honor the guaranty in the event of default because of the same high risk that only the government would accept and approve in the first place. The result here is to shift to a bank in central Wisconsin a loss of $3.2 million under a government program whose predictable costs the government now wants to walk away from.

Finally, the court of appeals engaged in unauthorized fact-finding contrary to Federal Rules of Civil Procedure 52(a) and in direct conflict with this Court's decision in *Icicle Seafoods, Inc. v. Worthington*, 475 U.S. 709 (1986). The Seventh Circuit here violated this Court's clear holding that although a court of appeals may set aside fact-finding as clearly erroneous, it has no authority to make substitute fact-finding of its own.

In addition, the Seventh Circuit's *sua sponte* pendent jurisdiction ruling also presents an important question that warrants this Court's review because: (1) it involves the same important interests and policies recognized by this Court when it recently granted the petition for writ of certiorari in *Finley v. United States*, No. 87-1973; (2) it creates a direct conflict with decisions of this Court regarding the standards for the exercise of pendent jurisdiction; and (3) it undermines the Congressional determination to provide a federal forum for the parties involved in, and claims arising out of, the EDA guaranty program.

I. THIS COURT HAS EXPRESSLY LEFT UNDECIDED THE QUESTION OF GOVERNMENTAL RESPONSIBILITY FOR THE ACTIONS OF AUTHORIZED GOVERNMENT OFFICIALS, CAUSING THE CIRCUITS TO APPLY DIFFERENT STANDARDS AND REACH INCONSISTENT RESULTS.

The question of when the federal government may avoid responsibility for the actions and knowledge of federal officials has been expressly left open by this Court and has received inconsistent treatment from the circuits. *Heckler v. Community Health Services of Crawford County, Inc.*, 467 U.S. at 60 ("[w]e have left the issue open in the past, and do so again today"); *Schweiker v. Hansen*, 450 U.S. 785, 788-89 n.4, 791-92 (1981) ("[t]his Court has never decided what type of conduct by a Government employee will estop the Government . . .," [and as noted by Justice Marshall in dissent] "the lower courts are left guessing . . . ."). The justification for limiting the situations where estoppel would be permitted against the government was set forth by this Court in *Heckler v. Community Health Services:*

> When the Government is unable to enforce the law because the conduct of its agents has given rise to an estoppel, the interest of the citizenry as a whole in obedience to the rule of law is undermined . . . [W]e are hesitant, . . . to say that there are *no cases* in which the public interest in ensuring that the Government can enforce the law free from estoppel might be outweighed by the countervailing interest of citizens in some minimum standard of decency, honor, and reliability in their dealings with their Government.

467 U.S. at 60; *see also Wilber National Bank v. United States*, 294 U.S. 120, 123-24 (1935); *Schweiker v. Hansen*, 450 U.S. at 795 (Marshall J., dissenting).

In this case not only the interest of the public, but express Congressional waiver of immunity, outweighs any consideration for "immunizing" the government from liability. It is not a case where estoppel would prevent enforcement of the law. On the contrary, Citizens dealt with the government over a period of years in a private, proprietary transaction pursuant to which the government exercised significant control, just as the statute intended. Nor is this a situation where a private citizen is presumed or expected to "know" what the statutes and regulations require because there are no regulations or guidelines for private lenders, other than the representations of the agency, which define or explain the boundaries of the government's idea of prudence and risk in the unique context of this type of federal credit program.

These circumstances distinguish the holdings in the "government estoppel" cases previously considered by this Court. *See, e.g. Heckler v. Community Health Services,* 467 U.S. at 60 (1984) ("[w]hen the Government is unable to enforce the law . . ."); *Schweiker v. Hansen,* 467 U.S. at 788 ("what type of conduct . . . will estop the Government from insisting upon compliance with valid regulations . . ."); *INS v. Hibi,* 414 U.S. 5 (1973) (enforcement of immigration laws); *Federal Crop Insurance Corp. v. Merrill,* 332 U.S. 380, 385 (1947) ("[t]he Wheat Crop Insurance Regulations were binding on all who sought to come within the Federal Crop Insurance Act, regardless of actual knowledge of what is in the Regulations. . ."); *Wilber National Bank,* 294 U.S. at 123, quoting the Circuit Court of Appeals, 69 F.2d 526, 527 (2d Cir. 1934) ("[t]he law does not permit waiving statutory requirements by the acts of employees of the government."); and *Utah Power & Light Co. v. United States,* 243 U.S. 389, 409 (1917) (United States not estopped "to do or cause to be done what the law does not sanction or permit.").

Further, the decision of the court of appeals is contrary to a significant rule declared by this Court: the government *does* assume responsibility for its actions in connection with

federal commercial programs and activities. *Franchise Tax Board v. United States Postal Service,* 467 U.S. 512, 520 (1984); *see also Loeffler v. Frank,* 108 S. Ct. 1965 (1988). Indeed, to require the government to honor its commitments when participating in commercial programs will ultimately promote governmental efficiency and reduce governmental waste.

In *Franchise Tax Board* this Court held that when Congress has "launched" a federal government agency into the "commercial world" by virtue of, *inter alia,* waiving sovereign immunity and permitting the agency to "sue or be sued," there is a presumption that the government agency's liability is the same as that of any other business. 467 U.S. at 520. This rule was followed recently in *Loeffler,* where this Court held that the "sue and be sued" clause must be liberally construed and found that the Postal Service is liable for prejudgment interest under appropriate circumstances, just as any other business. 108 S. Ct. at 1968-70.

In this case, *accountability, not immunity,* is appropriate where Congress "launched" the EDA into the commercial world pursuant to the Trade Act and permitted the Secretary of Commerce to "sue or be sued" under 19 U.S.C. § 2350. If the decision below is allowed to stand, the "be sued" language in 19 U.S.C. § 2350 becomes meaningless. The federal government would always be able to escape liability for financial obligations it undertook with its eyes wide open, with full knowledge and disclosure of the risks, while its officials lead private citizens down a path of false belief that the government is satisfied and will not seek to disavow its obligations. The law does not permit private financial intermediaries to engage in such unfair dealings and sharp practices. Nor did Congress intend for the government to do so.

The manifest unfairness of absolving the government from responsibility here is best illustrated by the Seventh Circuit's attention to Weber's 1981 financial statements. The court of appeals held that closing the loans in the

face of the 1981 financial statement was reason enough to allow the federal government now to disavow its guarantees to Citizens. However, under the terms of the guaranty program, the EDA, and not Citizens, was responsible for determining that the loans would be closed. Furthermore, the government had reviewed Weber's 1981 financial statements, had received the accounting firm's letter of concern before closing and had the opportunity to withdraw its guaranty, but instead chose to have Citizens proceed with the loans. It is wrong now to allow an appellate court to amend the guaranty agreements for the benefit of the federal government and arbitrarily impose the responsibility for closing the loans upon Citizens.[13]

A. The Failure To Resolve The Question of Governmental Responsibility Has Caused the Circuits To Apply Different Standards and To Reach Inconsistent Results.

The court of appeals' decision in this case conflicts with several recent decisions of other courts of appeals. Here the Seventh Circuit declared that all the elements of common-law estoppel must be met, and then, contrary to the district court, announced its own substitute findings that there were no "misleading silences" or "reliance by the bank." A.11. But several circuits have found the government accountable for its actions without specifically relying on the traditional elements of the estoppel doctrine. *See, e.g., Maxima Corp. v. United States,* 847 F.2d 1549, 1556-57, n. 6 (Fed. Cir. 1988) ("The need for mutual fair dealing is no less required in contracts to which the government is a party, than in any other commercial

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[13] Contrary to the court of appeals' suggestion that Citizens "waived" this argument, Citizens expressly argued below that the responsibility for closing Weber's Trade Adjustment Assistance loans was the EDA's, not Citizens'. A.9. Brief of Plaintiff-Appellee at 33-40, *Citizens Marine National Bank v. United States Dept. of Commerce.*

arrangement," and "that the government can always change the bargain, even long after performance of that bargain and whatever the facts, is [an] anathema not only to the rule of law but to the principles of a great commercial nation."); *Brown v. Marsh*, 777 F.2d 8, 16 (D.C. Cir. 1985) ("[T]he Army's conduct . . . more than justifies our refusal to allow it to raise its claim. . . .").

In addition, a confusing plethora of inconsistent and contradictory tests have emerged among the circuits applying equitable estoppel against the government. *See generally* Note, *Equitable Estoppel of the Government*, 79 Colum. L. Rev. 551 (1979). For example, the Ninth Circuit has developed an "affirmative misconduct" requirement. *Wagner v. Director, Federal Emergency Management Agency*, 847 F.2d 515 (9th Cir. 1988). The Fifth, Sixth, Ninth, Tenth and Eleventh Circuits, together with the Court of Claims, have at times applied a proprietary/sovereign distinction depending on which role the government's actions more closely resemble. *See, e.g., Federal Deposit Insurance Corp. v. Harrison*. 735 F.2d 408, 412 (11th Cir. 1984) (The "FDIC should be required to deal fairly with its debtors and should be held accountable for the representations of its agents"); *United States v. Mattucci*, 502 F.2d 883 (6th Cir. 1974); *New Mexico v. Aamodt*, 537 F.2d 1102 (10th Cir. 1976), *cert. denied* , 429 U.S. 1121 (1977); *United States v. Florida*, 482 F.2d 205 (5th Cir. 1973); *Branch Banking & Trust Co. v. United States*, 98 F. Supp. 757 (Ct.Cl. 1951), *cert. denied*, 342 U.S. 893 (1951). *See also United States v. Georgia-Pacific Co.*, 421 F.2d 92, 100, 103 (9th Cir. 1970) ("[I]t is hardly in the public's interest for the Government to deal dishonestly or in an unconscientious manner. This is especially imperative in a time when few individuals and corporations, if any, can escape numerous dealings with the Government and its agents." . . . "The claim of the government to an immunity from estoppel is in fact a claim to exemption from the requirements of morals and justice."); Berger, *Estoppel Against the Government*, 21 U. Chi. L. Rev. 680 (1954).

The lack of guidance concerning the standards for governmental responsibility has allowed lower courts to fashion different standards and devise contradictory, result-oriented decisions. The facts of this case warrant this Court's consideration of the governmental responsibility issues in order to clarify the law and provide the appropriate guidance to the lower courts.

B. Fundamental Principles of Guaranty Law Apply to the Government in This Commerical Transaction.

This Court recognized in *Lyng v. Payne,* 476 U.S. 926, 936 (1986), that the existence of "estoppel-like" considerations and "estoppel-like" effects resulting from the proper application of other distinct legal principles, does not require satisfaction of all the elements of common-law estoppel in order to decide a case. ("We reject [the] . . . suggestion that any remedy that can be analogized to an equitable estoppel is necessarily invalid, regardless of the source of the cause of action, unless the plaintiff succeeds in proving all the elements of common-law estoppel"). *See also Brown v. Marsh,* 777 F.2d at 16. Because the governmental responsibility issue here is resolvable in the context of appropriate principles of guaranty law, it is not necessary for Citizens to show all the elements of common law estoppel. Even if Citizens was required to do so, however, all of the elements of estoppel are present here. *See* Section II., *infra* at p. 23.

The EDA officials did much more than merely "turn a blind eye" or "wink" at Citizens as the court of appeals suggests;[14] the EDA controlled the course of the loan. The

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[14] When presented with completely private commercial situations the Seventh Circuit, and the author of its opinion here, certainly adhere to general principles of guaranty law and recognize the significance of the guarantor's knowledge; a guarantor may not escape liability because of increased risk *if he knows* of the risk and proceeds heedless of it. *United States Shoe Corp. v. Hackett,* 793 F.2d 161, 163 (7th Cir. 1986).

record is clear that Citizens informed the government of its actions as they occurred and provided all information the government requested.[15] The government did not object to the actions taken by Citizens or demand alternative courses of action. Though the court of appeals begrudgingly acknowledged these facts, it erroneously deemed them of no consequence merely because federal officials were involved. Certiorari should be granted to resolve the important question of whether the government's participation in commercial transactions pursuant to government credit programs *is of consequence* to the rights of private parties.

II. THE COURT OF APPEALS ENGAGED IN UNAUTHORIZED FACT-FINDING IN DIRECT CONFLICT WITH THIS COURT'S DECISON IN *ICICLE SEAFOODS, INC. V. WORTHINGTON.*

The court of appeals openly engaged in the very appellate fact-finding expressly condemned by this Court in *Icicle Seafoods, Inc. v. Worthington,* 475 U.S. 709, 714 (1986). To reach its result it found that the EDA had not misled Citizens even by silence, and that Citizens had not relied. A.11. It is bad enough for the court of appeals to throw out a district court's findings of fact for no apparent reason other than disagreement — it is quite another, and beyond the appellate power, for the court of appeals to substitute its own factual determinations. Such unauthorized appellate fact-finding presents reason enough for this

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[15] For example, the district court found that the EDA condoned Citizens' disbursement practices and was therefore precluded from *contending* that Citizens' procedure was unreasonable and imprudent. Furthermore, the procedures followed by Cititzens for the disbursement of loan funds were given prior approval by the government. R. 228.

Court to grant this petition and summarily reverse the court of appeals.[16]

The record showed without dispute that the government represented to Citizens its willingness to accept the credit risk for Trade Adjustment Assistance loans to Weber, and that Citizens otherwise would not have lent the money. That was the very purpose of the entire Trade Adjustment Assistance guaranty program: to induce lenders like Citizens to make loans they would not otherwise make. And the record without dispute, on stipulated facts, showed that the EDA was involved in and set requirements, which were observed, for every step of the transaction. A.21-60.

Yet the appellate panel found that "there were no promises, misrepresentations, or misleading silences, and there was no reliance by the bank." A.11. The court of appeals' determination of these facts may very well be consistent with a free market economic philosophy hostile to such government programs, but it is simply not supported by Congressional intent,[17] the reality of this government program, and most importantly the record.

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[16] There is also absolutely no record support for the appellate finding that Citizens was "tempted" to improve its position by way of the government guaranty program. A.8. Pursuant to its own guidelines, and prior to closing the loan, the EDA had performed a specific analysis and determined that Citizens was more, or equally, exposed after the loan guarantees as compared to before. Ex. 37; R. 188. Furthermore, Citizens was required to subordinate to EDA its position regarding Weber's debt prior to Weber's application for Trade Adjustment Assistance. The only explanation for the panel's view is unfounded speculation, which pervades its entire consideration of the record.

[17] The court of appeals also misconstrued and misapplied the "reasonable assurance of repayment" requirement. It stated:

> The Trade Act of 1974 authorizes the government to make risky loans (or loan guarantees)—indeed, *requires* that they be risky, since a condition precedent

Continued

The court of appeals' unsupported conclusion that the EDA officials "who exercised inadequate oversight in this matter [did not have] any actual or apparent authority" is not only incorrect, but merely begs the central question of governmental responsibility. The situation here is far more compelling than that presented to this Court in the *Heckler v. Community Health Services* case, 467 U.S. 51, where a non-government party was acting as a governmental "agent" under the Medicare program. Here, the EDA officials acted with both actual and apparent authority through formal delegation in accordance with federal law. A.30-32, 35-43, 82; Ex.7.

Because the court of appeals stepped well beyond what this Court found to be inappropriate fact-finding in *Icicle,* review of this case is necessary.

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[17] *Continued from previous page*

> is that the borrower be unable to obtain financing on ordinary terms in the private capital markets. But the Act also requires that there be at least a reasonable assurance of payment, and this requirement was implemented by the altogether sensible provision in the guaranty agreement requiring the bank to act with the prudence of a normal commerical bank that had made a loan not guaranteed by the federal government.

A.10-11. However, the reasonable assurance of repayment requirement must be satisfied *by the EDA after* the EDA's certification and *prior* to the EDA's approval of Trade Adjustment Assistance. *See* 19 U.S.C. §2345(a)(2); A.52. To suggest that the "reasonable and prudent commercial bank" provision of the guaranty agreement, which clearly only applied to post closing actions by Citizens, somehow "implements" the "reasonable assurance of repayment" requirement under the Act, evidences the tortured analysis used by the court of appeals to reach its result.

III. THE COURT OF APPEALS' PENDENT JURISDICTION RULING IS IN DIRECT CONFLICT WITH DECISIONS OF THIS COURT.

Certiorari should be granted also to review the court of appeals' pendent-jurisdiction ruling regarding Citizens' claim against the Hutchinsons on their guaranty because: (1) it involves the same important interests and policies recognized by this Court's recent grant of certiorari in *Finley v. United States, cert. granted,* No. 87-1973; (2) it is directly contrary to the principles and standards of pendent jurisdiction declared by this Court; (3) it abrogates the intent of Congress regarding the EDA program; and (4) it is grounded in a philosophical view of federal jurisdication not supported in the law and is reached only by a selective review of the record.

In *Finley,* the plaintiff brought claims against the United States properly invoking the jurisdiction of the federal district court. The plaintiff then moved to amend her complaint to add claims against third parties for which no independent basis for federal jurisdiction existed. The district court held that since the litigation arose from a common nucleus of operative fact, judicial economy, efficiency and fairness mandated that the case be resolved in one forum. Prior to a determination on the merits of the claims, the pendent jurisdiction issue was certified to the Ninth Circuit, which reversed the district court.

Even more significant circumstances and considerations of judicial economy, efficiency and fairness are presented in this case. Here, Citizens asserted claims against the governmental defendants and properly invoked the jurisdiction of the district court. Citizens also asserted claims against third parties, the Hutchinsons. But, in addition, the Hutchinsons asserted a claim against the government relating to the EDA's interest in the

collateral arising out of the guaranty loan transactions.[18] The district court not only exercised jurisdiction over all these related claims, but, unlike *Finley*, proceeded to address and determine the merits of those claims. A.61, 70. Thus, the appellate panel's decision vacating Citizens' judgment against the Hutchinsons accomplishes only what the pendent jurisdiction doctrine is intended to avoid: duplicative litigation and judicial inefficiency and waste. *See Carnegie-Mellon University v. Cohill,* 108 S. Ct. 614, 618 (1988); *United Mine Workers of America v. Gibbs,* 383 U.S. 715, 726 (1966). Moreover, instead of applying "the common nucleus of operative fact" standard, the Seventh Circuit here required identity of "the facts upon which the determination of liability . . . [is] based." A.7.

In *Cohill,* this Court found, just last Term, that multiple federal and state claims, as divergent as a violation of federal age-discrimination law and a state defamation claim, arose from a "common nucleus of operative fact": the dismissal of an employee. 108 S.Ct. at 619. As in *Cohill,* Citizens' claim against the EDA and Citizens' claim against the Hutchinsons on their guaranty arise from a "common nucleus of operative fact": Weber's default on the loans. The EDA guaranty, pursuant to the EDA program, required the Hutchinsons' guaranty as a necessary element of the Weber Trade Adjustment loan. In fact, the Hutchinsons' guaranty was a required item of collateral in which the EDA itself obtained an interest. Exs. 2-6, 10-13, 50, 76, 77.

The court of appeals improperly stripped the district court of its broad discretion to hear Citizen's claim against the Hutchinsons, only to send the same parties off to relitigate the same claim in a different forum. It also

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[18] The district court granted summary judgment against the Hutchinsons on this claim. However, the court of appeals never considered the effect of the assertion of the Hutchinsons' claim against the government on the pendent jurisdiction issue between Citizens and the Hutchinsons.

undermined the Congressional determination to provide a federal forum for parties involved in transactions arising under the EDA loan program. Certiorari is necessary to clarify the scope and application of the pendent-party jurisdiction doctrine and to correct the Seventh Circuit's unjustified restriction of pendent jurisdiction in this case.

CONCLUSION

For the reasons stated, certiorari should be granted.

Respectfully submitted,

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In The Supreme Court of the United States October Term, 1988

BANK ONE, STEVENS POINT, NA,

Petitioner,

v.

UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, C. WILLIAM VERITY in his official capacity as Secretary of Commerce, UNITED STATES OF AMERICA, REMER HUTCHINSON, and ELAINE HUTCHINSON,

Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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In the
United States Court of Appeals
For the Seventh Circuit

Nos. 87-2705, 87-2789

CITIZENS MARINE NATIONAL BANK, formerly the CITIZENS NATIONAL BANK OF STEVENS POINT,

Plaintiff-Appellee,

v.

UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, C. WILLIAM VERITY in his official capacity as Secretary of Commerce, UNITED STATES OF AMERICA, REMER HUTCHINSON, and ELAINE HUTCHINSON,

Defendants-Appellants.

Appeal from the United States District Court for the Western District of Wisconsin.
No. 85 C 637—**John C. Shabaz**, *Judge.*

ARGUED APRIL 22, 1988—DECIDED AUGUST 8, 1988

Before WOOD, JR. and POSNER, *Circuit Judges*, and ESCHBACH, *Senior Circuit Judge.*

POSNER, *Circuit Judge.* Citizens Marine National Bank, a bank in Stevens Point, Wisconsin, was owed almost $1 million by a troubled local enterprise, the Weber Tackle Company, as a result of a series of loans that Citizens had made to Weber over the years. In 1979, Mr. and Mrs. Hutchinson bought a controlling interest in Weber, and also loaned the company in excess of $200,000, most of

which has never been repaid. Weber's perilous condition did not improve, and in 1981 Weber and the bank sought and obtained from the Economic Development Administration of the U.S. Department of Commerce a guaranty of 90 percent of a new $2.1 million loan by the bank to Weber. The Trade Act of 1974, 19 U.S.C. §§ 2341 *et seq.*, authorized the Economic Development Administration (we use the past tense because this part of the Act is defunct, having been repealed for reasons well discussed in *International Trade Administration Trade Adjustment Assistance: No Cure for Import-Injured Firms* (U.S. Dept. of Commerce, Office of Inspector General, Rep. No. D-068-5-006, March 1985)) to provide financial assistance to American firms that had been badly hurt by imports, had "no reasonable access to financing through the private capital market," yet provided "reasonable assurance of repayment of the loan." 19 U.S.C. §§ 2342(b)(1)(A), 2345. Obviously, "reasonable" here is a term of art, since private financial institutions will happily lend money whenever there is a reasonable assurance of repayment. The Senate Report explains that "reasonable assurance of repayment" "should not be taken to mean reasonable assurance of repayment in the strict banking or commercial sense because adjustment assistance loans are admittedly high risk loans." S. Rep. No. 1298, 93d Cong., 2d Sess. 149 (1974). Of course plenty of high-risk loans are made in the private sector, but a federal guaranty would reduce the interest rate that the borrower had to pay.

At all events, the guaranty agreement between the bank and the Economic Development Administration required the bank to "execute [doubtless a typo for 'exercise'] such care and diligence in the disbursement, servicing, collection and liquidation of the Loan as would be exercised by a reasonable and prudent commercial bank in dealing with a loan of its funds without guaranty," and provided that if the bank "failed to comply with all of the material provisions" of the agreement the government could terminate the guaranty. In connection with the guaranty the Hutchinsons signed two agreements with the bank. In one

they guaranteed the $2.1 million loan to Weber but the bank agreed not to enforce the guaranty against the Hutchinsons' home. In the other the bank agreed: (1) Upon payment in full by Weber of the loan guaranteed by the Economic Development Administration, the Hutchinsons—to whom Weber owed almost $200,000—would be entitled to the repayment of their loan, above $50,000, "prior to payment of any other claims or indebtedness owing by [Weber] to the" bank. (2) If Weber was liquidated, the Hutchinsons would be entitled to the repayment of their loan (again, all but $50,000) from the distribution of such assets as the bank might "receive or be entitled to receive on any Junior Indebtedness in connection with any such . . . liquidation."

The loan was closed in December 1981. Ten months later Weber defaulted; it has since gone out of business. The bank sued Weber in state court, seeking to foreclose on Weber's assets that had secured the loan. Weber responded with a third-party complaint against the government defendants. The basis of that complaint is obscure, but the idea may have been that Weber was a third-party beneficiary of the guaranty agreement and that if the government made good on its loan guaranty to the bank, the bank might ease up on its efforts to seize Weber's assets. At all events, after removal of the case the district court allowed the parties to revamp the litigation: Weber dropped its third-party complaint (and effectively dropped out of the litigation), and the bank filed a complaint against the government—which had announced that it would indeed refuse to make good on its guaranty to the bank. The bank's complaint based jurisdiction on 19 U.S.C. § 2350, which empowers the Secretary of Commerce to sue or be sued, for any amount of money, with respect to claims arising from the Trade Act of 1974, thus enabling this suit to be maintained notwithstanding the Tucker Act. The Tucker Act allows persons having non-tort claims against the United States or its agencies for $10,000 or more to litigate those claims in the Claims Court, so, in the absence of any other statute waiving

the sovereign immunity of the United States, that is the only place they may be litigated—but section 2350 is such another statute. Cf. *Van Drasek v. Lehman*, 762 F.2d 1065, 1071 and n. 10 (D.C. Cir. 1985); *Munoz v. Small Business Administration*, 644 F.2d 1361, 1364 (9th Cir. 1981); *Pacificorp. v. Federal Energy Regulatory Comm'n*, 795 F.2d 816, 826 (9th Cir. 1986) (concurring opinion).

The bank named as additional defendants the Hutchinsons, who had also guaranteed the loan, and who now counterclaimed against the bank for $150,000, the amount they claimed to be owed by virtue of their second agreement with the bank. This claim is based on state rather than federal law, but the bank contends that it is within the district court's jurisdiction by virtue of the "pendent parties" concept.

The district judge granted summary judgment for the bank on its claim against the Hutchinsons, and they appeal. The bank's claim against the government was the subject of a one-day bench trial, after which the judge held that although the bank had behaved imprudently in administering the loan, so had the government, and the bank had not committed a *material* breach of its obligations under the guaranty and therefore was entitled to judgment (which with interest comes to $3.1 million). The government appeals.

There are first some jurisdictional issues to address:

1. The original case filed by the bank was not properly removed to the federal district court, for we have held that third-party defendants, including the United States and its agencies, cannot remove (with immaterial exceptions) suits in which the main claim is based on state law. *Thomas v. Shelton*, 740 F.2d 478 (7th Cir. 1984). However, the issue of "removability" was made moot by the filing in the district court of a complaint (by the bank, against the government) that was within the court's original jurisdiction. *Graf v. Elgin, Joliet & Eastern Ry.*, 790 F.2d 1341, 1343 (7th Cir. 1986); *Bernstein v. Lind-Waldock & Co.*, 738 F.2d 179, 185-86 (7th Cir. 1984).

2. The statute under which the bank sued the government lifts the bar of sovereign immunity only for the Secretary of Commerce, and not for the other federal defendants. As no separate relief is sought against the other defendants—indeed, they are as a practical matter synonyms for the Secretary of Commerce (who when sued, as here, in his official rather than personal capacity is merely an *alter ego* of the United States)—this jurisdictional error is of no consequence. Nevertheless the other defendants should have been dismissed. Cf. *Weeks Construction, Inc. v. Oglala Sioux Housing Authority*, 797 F.2d 668, 674-75 (8th Cir. 1986).

3. A more consequential jurisdictional issue relates to the pendent-party claim against the Hutchinsons. Where A (the bank) brings a federal suit, based on federal law, against B (the Secretary of Commerce) and also has a claim under state law against C (the Hutchinsons), we generally allow the district court to exercise jurisdiction over the state-law claim. This is "pendent party" jurisdiction, on which see, e.g., *Price v. Pierce*, 823 F.2d 1114, 1119 (7th Cir. 1987); *Vantine v. Elkhart Brass Mfg. Co.*, 762 F.2d 511, 518-19 (7th Cir. 1985); *Moore v. Marketplace Restaurant, Inc.*, 754 F.2d 1336, 1359-61 (7th Cir. 1985) (separate opinion, but expressing majority view on this point); *In re Oil Spill by Amoco Cadiz*, 699 F.2d 909, 913-14 (7th Cir. 1983); *Weinberger v. Kendrick*, 698 F.2d 61, 76-77 (2d Cir. 1982). However, in *Bernstein v. Lind-Waldock & Co.*, *supra*, 738 F.2d at 187, we described the concept of pendent-party jurisdiction as "embattled," an impression strengthened by the discussion and references in 13B Wright, Miller & Cooper, Federal Practice and Procedure § 3567.2 (2d ed. 1984). *Bernstein* noted that the concept has been rejected where the main claim is based on state law (and is therefore within federal jurisdiction only by virtue of the diversity statute), see *Zahn v. International Paper Co.*, 414 U.S. 291, 292, 300-02 (1973); *Sarnoff v. American Home Products Corp.*, 798 F.2d 1075, 1079 (7th Cir. 1986), and that in *Aldinger v. Howard*, 427 U.S. 1 (1976), the Supreme Court had held that the concept could not be used

to join a state-law claim against a municipality with a federal civil rights claim against an employee of the municipality. See also Judge Coffey's discussion of *Aldinger*, dissenting in the *Moore* case, 754 F.2d at 1353; and *Charles D. Bonanno Linen Service, Inc. v. McCarthy*, 708 F.2d 1, 6-11 (1st Cir. 1983).

The best generalization about the current status and scope of pendent-party jurisdiction may be that no generalization is possible; the second best may be that, unsatisfactory as it is to have a sliding scale for jurisdiction, the existence of pendent-party jurisdiction depends on the pros and cons of exercising such jurisdiction in particular circumstances. However, if it appears as in *Aldinger* that Congress would not have wanted the federal courts to exercise jurisdiction over the pendent claim, then there is no pendent-party jurisdiction; and that may be the case here. The statute on which the district court's jurisdiction over the main claim (the bank's claim against the Secretary of Commerce) is based is narrowly drawn; as a grant of jurisdiction over suits by private parties, such as the bank, all it does is lift the bar of sovereign immunity with respect to claims arising out of the Trade Act of 1974 (in fact, to just a subset of such claims). It would be odd if a jurisdictional statute of such limited and specialized purpose allowed the plaintiff fortunate enough to be able to get into district court under it to haul in a *non*governmental party (who could not in any event plead the defense of sovereign immunity) against which the plaintiff had a claim purely of state law, arising from an agreement collateral to the agreement with the governmental party on which the main claim was based. There is some question whether the Claims Court has, or would ever exercise, any form of pendent jurisdiction, see *Strick Corp. v. United States*, 625 F.2d 1001, 1010 (Ct. Cl. 1980); *ATL, Inc. v. United States*, 4 Cl. Ct. 672, 676 (Cl. Ct. 1984), yet that is the court this case would be in but for section 2350, and there is great doubt that Congress by enacting that statute sought to confer a more capacious jurisdiction on the district court.

So maybe there can be no pendent-party jurisdiction in suits under 19 U.S.C. § 2350; but this we need not decide. Pendent jurisdiction is limited to claims that involve the same "nucleus of operative facts" as the main claim. *United Mine Workers v. Gibbs*, 383 U.S. 715, 726 (1966). The same limitation applies to pendent-party jurisdiction, offshoot of pendent-claim jurisdiction that it is. *Zabkowicz v. West Bend Co.*, 789 F.2d 540, 546 (7th Cir. 1986); *Vantine v. Elkhart Brass Mfg. Co.*, *supra*, 762 F.2d at 518. The only relationship between the bank's claim against the Secretary of Commerce and its claim against the Hutchinsons is that the two claims have a common origin in the loan to Weber and the guaranty of that loan by the Economic Development Administration. The operative facts—the facts upon which the determination of liability in the two cases was based—are separate nuclei with much space between them. The bank's claim against the Economic Development Administration concerns the terms of the guaranty agreement and the behavior of both the bank and the EDA in administering the loan. The bank's claim against the Hutchinsons involves the terms of its agreement with the Hutchinsons. There is no overlap of legally pertinent facts or legal principles. The only argument the Hutchinsons make in their appeal is that the agreement in question could not be interpreted, as the district court thought, without taking evidence, because (they say) the agreement is inconsistent with their other agreement with the bank. These agreements have nothing more in common with the loan guaranty than a common origin in Weber's travails. That is not enough. If there is ever pendent-party jurisdiction in a case under 19 U.S.C. § 2350, it is not this case, and we therefore direct the district court to dismiss the bank's claim against the Hutchinsons.

That brings us to the merits of the government's appeal. The government argues that the bank violated the terms of the loan guaranty. The argument is virtually unopposed, the bank having waived, as we shall see, its most promising counterargument. The agreement required the bank to administer the loan in the same fashion as

would a "reasonable and prudent commercial bank" in dealing with a loan that had not been guaranteed by the United States Government. This provision was essential. The bank was deeply in the hole as a result of its prior loans to Weber. The government's loan guaranty offered it a way of climbing out. The temptation, against which the quoted provision was aimed, was for the bank to allow Weber to take risks with the money, since if the risks paid off, the bank would be repaid, while if the risks did not pay off, the incremental loss to the bank (10 percent of $2.1 million) would be small. Moreover, if Weber kept its head above water long enough to repay its earlier indebtedness of $1 million to the bank, the bank would be better off to the tune of $790,000 ($1 million minus $210,000), even if Weber defaulted on the later loan.

The bank yielded to temptation—notably when, only weeks before the loan closed, it failed to take any action with respect to a devastating financial statement issued by Weber's auditors for 1981. The statement showed that instead of losing a "mere" $250,000 that year—as Weber's "economic recovery plan," required by the Economic Development Administration as a condition precedent to financial assistance, showed—Weber had lost more than twice that amount. If the bank had been acting as a reasonable and prudent commercial lender, uncushioned by a federal loan guaranty, it would have reevaluated the making of the loan, in light of the collapse of Weber's relatively roseate prospects.

Later, after the loan closed, the bank engaged in other imprudent practices. It allowed Weber to purchase fixed assets without getting the bank's permission, even though such purchases, by reducing the borrower's liquidity and increasing his fixed costs, increase the danger of default. Then, after Weber defaulted, the bank continued advancing Weber money from the undisbursed portion of the $2.1 million loan, and also allowed Weber to issue overdrafts and to repay them out of its accounts receivables; these acts of forbearance diminished the assets available to pay back the loan.

Since the agreement required the bank only to exercise care and diligence in the "disbursement, servicing, collection and liquidation of the Loan," it could be argued that careless conduct in making the loan was not covered, for the making of the loan necessarily preceded disbursement, servicing, etc. The argument is supported by the fact that the quoted language appears in a section of the guaranty captioned "obligations of lender subsequent to disbursement," although there is an inconsistency between "[conduct] subsequent to disbursement" (the caption) and "disbursement" itself (the body of the section). But some of the careless acts occurred after the contract was made, as we have just noted; more important, the bank does not make the argument we have just sketched, and it is therefore waived.

The district judge agreed with the government that the bank had acted imprudently. We add: the bank's conduct amounted to a material breach (to this vital question the district court devoted only a sentence in its opinion—a sentence announcing a bare conclusion that the breach was not material), which therefore excused the government from performing its obligations under the guaranty. For, unlike the breach in *Eastern Illinois Trust & Savings Bank v. Sanders*, 826 F.2d 615 (7th Cir. 1987), it both concerned a central undertaking of the promisor and seriously damaged the promisee, the government, which is out $2.1 million as a result of the bank's carelessness in going through with the loan in the face of mounting evidence of Weber's incapacity to repay it. The bank argues, it is true, that even if it had acted with meticulous bankerly circumspection it would have made the loan and the government would have guaranteed it. The argument is pertinent; a breach that is material is the equivalent of the trial error that is not harmless: "it is not in society's interest to permit a party to abuse this protection [of his justified expectations] by using an insignificant breach as a pretext for avoiding his contractual obligations." Farnsworth, Contracts § 8.15, at p. 607 (1982). But the evidence overwhelmingly established that this undemanding standard

was satisfied, and the district court's (unexplained) disagreement with this conclusion we deem clearly erroneous. If the bank had acted prudently at the outset, then upon discovering that Weber was losing money twice as fast as expected the bank would not have made the loan at all (but for the government's guarantee) and then the government's money would never have been placed at risk. The later acts of imprudence, we agree, were less important; but the cumulative picture is one of material breach, and voided the guaranty.

The district court believed that in any event the bank's imprudence was somehow cancelled by the government's. Three ideas seem merged here: that the government broke its side of the bargain; that by winking at the bank's carelessness the government in effect modified the guaranty agreement; that the government is in any event estopped by its conduct to complain of the bank's breach.

The government had received a copy of Weber's 1981 financial statement before the loan closed, and could have withdrawn from the deal, but didn't. And the employees of the Economic Development Administration who supervised the transaction with the bank became aware of many of the bank's imprudent practices yet turned a blind eye. But nothing in the guaranty agreement enjoins the guarantor to vigilance—which scotches the suggestion that the government is guilty of a breach of contract too. Nor had these subordinate officials of the Economic Development Administration who exercised inadequate oversight in this matter any actual or apparent authority to modify the terms of the guaranty. Compare *United States v. Medico Industries, Inc.*, 784 F.2d 840, 845-46 and n. 2 (7th Cir. 1986). The Trade Act of 1974 authorizes the government to make risky loans (or loan guarantees)—indeed, *requires* that they be risky, since a condition precedent is that the borrower be unable to obtain financing on ordinary terms in the private capital markets. But the Act also requires that there be at least a reasonable assurance of payment, and this requirement was implemented by the

altogether sensible provision in the guaranty agreement requiring the bank to act with the prudence of a normal commercial bank that had made a loan not guaranteed by the federal government. The failure of the Economic Development Administration's regional staff to insist upon compliance with this provision—their attempt, perhaps, to make the Trade Act of 1974 a more charitable measure than Congress had intended—does not open the vaults of the Treasury to a bank that violated the provision.

The question whether and in what circumstances the federal government can be estopped by an act of its agents remains unsettled, but it is at least clear that "however heavy the burden might be when an estoppel is asserted against the Government, the private party surely cannot prevail without at least demonstrating that the traditional elements of an estoppel are present." *Heckler v. Community Health Services*, 467 U.S. 51, 61 (1984). (On what more might be required, see, e.g., *Morgan v. Heckler*, 779 F.2d 544, 545 (9th Cir. 1985).) That sinks the bank's estoppel argument, for there were no promises, misrepresentations, or misleading silences, and there was no reliance by the bank. See, e.g., *Azar v. United States Postal Service*, 777 F.2d 1265 (7th Cir. 1985); *Wisconsin Winnebago Business Comm. v. Koberstein*, 762 F.2d 613, 620 (7th Cir. 1985); *Prize Steak Products, Inc. v. Bally's Tom Foolery, Inc.*, 717 F.2d 367 (7th Cir. 1983). The government did not come down hard on the bank's imprudent practices, but neither did it direct or encourage them.

The judgment for Citizens against the Hutchinsons is vacated with directions to dismiss the bank's complaint against them for lack of federal jurisdiction, and the judgment for Citizens against the federal defendants is reversed with directions to dismiss its claim against them on the merits. There will be no award of costs in this court.

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IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WISCONSIN

CITIZENS MARINE NATIONAL BANK, formerly the Citizens National Bank of Stevens Point,

Plaintiff,

v.

WEBER TACKLE COMPANY, a Wisconsin corporation, and WEBER PLASTICS, INC., UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, MALCOLM BALDRIDGE, in his official capacity as Secretary of Commerce, or his Successor, UNITED STATES OF AMERICA, and REMER HUTCHINSON and ELAINE HUTCHINSON,

Defendants.

ORDER

85-C-637-S

Plaintiff Citizens Marine National Bank loaned Weber Tackle Company and Weber Plastics, Inc. $2,100,000, which was guaranteed by the Economic Development Administration (EDA). Weber failed to repay the loans, and Citizens brought this action against the EDA in an attempt to recover on the guarantees. Trial was to the Court on August 13, 1987. After hearing the evidence and reviewing the exhibits, the Court makes the following findings of fact.

FACTS

During 1979, Weber approached Citizens for loans to finance its fishing tackle operations and plastic products manufacturing facility and to purchase new equipment and modernize existing equipment used in Weber's operations. Because of the unsatisfactory credit history and large debt of the company, Citizens, as well as other area banks, determined that it would not loan Weber the requested funds.

On or about October 16, 1980, Weber applied for financial assistance in the form of a loan guaranty from the U.S. Department of Commerce, Economic Development Administration Trade Adjustment Assistance Program. As a necessary step in the EDA loan guaranty application process, a Diagnostic Analysis and recovery Plan for Weber was prepared by Weber and Midwest TAAC. Midwest TAAC was under contract with the EDA and was paid by the EDA for services in analyzing and preparing Weber's Recovery Plan.

In preparing the Recovery Plan, Midwest TAAC visited the Weber facilities, consulted with Weber's management, evaluated Weber's management capability, and analyzed the market for Weber's products. Midwest TAAC dealt directly with the borrower and with the EDA officials involved. Midwest TAAC did not solicit Citizens' opinions when preparing the Recovery Plan.

An initial draft of the Recovery Plan was completed and provided to the EDA and Citizens for review. That plan was then revised because Citizens determined that the initial plan did not provide sufficient working capital funds. The final proposed plan was then submitted by Midwest TAAC to the EDA.

The EDA's financial analysts then examined Weber's application and recovery plan. The EDA determined that the final recovery plan was viable and that Weber's management was capable of implementing the

recovery plan. The EDA's financial analyst recommended in an EDA "Action Memorandum" dated July 22, 1981, that Weber's application be approved. On or about September 18, 1981, the EDA offered to enter into a Working Capital Guaranty and a Fixed Asset Guaranty with Citizens. Citizens accepted the guaranties on September 24, 1981. The Weber loans and guaranty agreements were closed on December 17, 1981.

Pursuant to the Working Capital Guaranty, the working capital loan was to be used for financing the operations of Weber's fishing tackle and plastic products manufacturing facility. The Working Capital Guaranty provided that Citizens should obtain sufficient documentary information of disbursement use before making disbursements of working capital loan funds to Weber. Citizens required Weber to submit a requisition form that certified that funds were needed and were being used for working capital purposes. Citizens relied on Hutchinson's credibility when he certified that the loan funds were being used for authorized purposes.

Pursuant to the Fixed Asset Guaranty, the fixed asset loan was to be used for the purpose of purchasing new equipment and modernizing existing equipment in Weber's fishing tackle and plastic products manufacturing operations. Under the disbursement procedure followed by Citizens and Weber, Weber would first incur the expense of the fixed asset. Next, Weber would submit requisition forms to Citizens with attached invoices for the expended funds. Citizens would then ascertain whether the request for the disbursements was made in accordance with the requirements of the Fixed Asset Guaranty.

All the working capital and fixed asset funds were disbursed directly into the checking account at Citizens used by Weber Tackle Company and Weber Plastics, Inc. This checking account was also maintained in the name

of Weber International, Inc., although prior to March 1985 Weber International was not an operating business or a going concern.

Weber defaulted on the working capital loan and the fixed asset loan by failing to make the payments required on or by October 18, 1982. Citizens notified the EDA by letter dated October 28, 1982. The EDA was also aware that Weber was in violation of certain negative covenants of the guaranty agreements, and that Citizens was continuing to make loan disbursements to Weber while the loan was in a default.

On June 15, 1984, Citizens demanded that the EDA honor its guaranty commitments and repurchase the EDA guaranteed portion of the loans. On February 20, 1986, the EDA refused to acknowledge liability on its guaranty agreements.

In addition to the facts found by the Court, it also adopts the complete statement of uncontested facts set forth in the Joint Final Pretrial Report filed on August 7, 1987, and incorporates other facts as may be found in the opinion which follows.

OPINION

Citizens made Weber a $2,100,000 loan, 90 percent of which was guaranteed by the EDA. Weber subsequently defaulted on the loan and Citizens demanded that the defendants honor the guaranty. The defendants refused, contending they were released from liability because Citizens did not follow "reasonable and prudent" commercial banking practices. In their answer to the complaint the defendants allege numerous breaches of Citizens' duty to use "reasonable and prudent" commercial banking practices. At trial, however, the defendants only presented evidence and argument on a few alleged breaches of duty. The Court is principally concerned with six.

The first item of concern is the Weber Tackle Com-

pany and Subsidiary Financial Report for the year ended July 31, 1981. The cover letter dated November 13, 1981 is addressed to Remer Hutchinson. The report clearly showed that Weber did not meet the projections set forth in the recovery plan for the 1980/81 fiscal year. The fact that Weber did not meet the 1980/81 projections should have raised questions concerning the viability of the recovery plan.

Defendants contend that Citizens knew of the Financial Report and its possible consequences, but nevertheless failed to inform the EDA of its knowledge. The defendants contend that this was a breach of Citizens' fiduciary duty to the EDA. Alternatively, the defendants contend that if Citizens did not obtain the Financial Report prior to the closing, Citizens was negligent when closing the loan without the information.

From the evidence presented at trial, the Court is unable to determine whether Citizens had the financial report prior to closing. The Court does find, however, that both Citizens and the EDA could have and should have received the financial report prior to closing the Weber loans. Since the EDA and Citizens either failed to obtain or address the report, the EDA and Citizens must each bear responsibility for imprudent actions when closing the loans.

The second issue of concern is Citizens' procedure for disbursing fixed asset loan funds. The Court is distressed that the Bank would allow a failing business to incur fixed asset expenses before obtaining Bank approval for those expenditures. The EDA, however, obviously condoned these practices, following these same sloppy procedures itself. According to the deposition summary of Wayne Schroeder, a financial analyst with the EDA, "[t]he government's procedure for disbursing fixed asset funds includes obtaining a written statement from the borrower on a form used by the EDA together

with attached invoices indicating the machinery and equipment purchased. The form with which Schroeder was familiar did not specify the use of the proceeds. If the EDA had such a written request from the borrower, with an invoice of the item or items purchased, that would normally be sufficient to allow disbursement." Since the EDA followed essentially the same procedure for disbursing fixed asset loan funds as Citizens, the EDA is estopped from contending that Citizens' procedure was unreasonable and imprudent.

The third issue of concern is Citizens' practice of disbursing loan proceeds after Weber had defaulted on the loan. The Court is also distressed by this practice, but again, the EDA acquiesced in Citizens' actions. Ken Schmidt of Citizens told Wayne Schroeder of the EDA that Citizens was continuing to disburse loan proceeds to Weber after Weber's default. The EDA, however, never protested these continuing disbursements. Since the EDA knew of the disbursements after default and did not either complain or protest, the Court finds that the government is estopped from contending that Citizens' practice was unreasonable and imprudent. Both parties apparently believed that continued payments to this stressful business would somehow improve the prospects of collectibility!

The fourth issue is Citizens' disbursement of loan proceeds into a checking account jointly controlled by Weber Tackle, Weber Plastics, and Weber International. The government contends that depositing the loan proceeds into a checking account controlled by Weber International, an entity not party to the loan, was imprudent. Citizens' actions in depositing loan proceeds into a checking account controlled by Weber International was imprudent, however, the Court finds no evidence to indicate that the defendants were harmed by such actions. Remer Hutchinson testified that all of the loan proceeds were used for the benefit of Weber

Tackle and Weber Plastics. There is no evidence to the contrary. Since the defendants were not harmed by the Bank's action in depositing the loan proceeds into Weber International's checking account, the government may not be released from its guaranty.

The fifth issue is Citizens' practice of allowing Weber to maintain substantial overdrafts. Although the evidence clearly showed that Citizens did allow Weber to maintain substantial overdrafts, there was no evidence to show that the defendants were harmed by such a practice. The defendants were not harmed by Weber's overdrafts which occurred before the loan closing because they knew about these overdrafts and approved them before executing the loan with Weber. The defendants were not harmed by Weber's overdrafts which occurred after the loan closing because, as testified by Joseph Braunger, plaintiff's expert, the risk of harm from the overdrafts was Citizens. Since defendants were not harmed by Citizens' practice of allowing overdrafts, the defendants may not be released from their guaranty.

Finally, no evidence of harm has been presented by defendants for any failure of plaintiff to demand of Weber strict adherence to the negative covenant provisions.

After examining defendants' arguments that Citizens did not use "reasonable and prudent" commercial banking practices, the Court concludes that either the defendants are estopped by their own actions from asserting that Citizens failed to use reasonable and prudent commercial banking practices or that defendants were not harmed by Citizens' use of such practices. There has been no substantial and material breach of duty by plaintiff. Accordingly, the Court concludes that the EDA should not be released from its guaranty on the working capital and fixed asset loans.

There is no question that this is another government loan that should never have been made. This less-than-marginal, stressful business, scrambling for bases, lost

money for many prior years, had a negative net worth and little probability of success. Because of Weber's precarious financial position, Citizens, as well as all other financial institutions, determined that Weber should not receive the requested funds. The government, however, became involved, and the loan which should never have been made was granted.

The defendants having apparently belatedly recognized their error in business acumen, have now determined that others are to blame. The government's interest in recovering these misplaced funds is commendable, however, it cannot require others to follow reasonable and prudent practices when the government itself follows unreasonable and imprudent practices.

Regardless of the Bank's practices, this loan was doomed from its inception, and the government cannot now be heard to complain when it has only itself to blame for the losses which have occurred.

Accordingly, judgment is granted in favor of the plaintiff in the amount of $2,795,523.31, together with interest thereon from August 13, 1987.

ORDER

IT IS ORDERED that judgment is granted in favor of the plaintiff and against the defendants United States Department of Commerce, Economic Development Administration, Malcolm Baldridge, in his official capacity as Secretary of Commerce, or his Successor, and United States of America, in the amount of $2,795,523.31, together with interest thereon from August 13, 1987, and costs.

Entered this 18th day of August, 1987.

BY THE COURT:
/s/ JOHN C. SHABAZ
JOHN C. SHABAZ
District Judge

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WISCONSIN

CITIZENS MARINE NATIONAL BANK,

Plaintiff,

vs.

Case No. 85-C-637S

WEBER TACKLE COMPANY, et al.,

Defendants.

JOINT FINAL PRETRIAL REPORT*

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* * *

II. AGREED STATEMENT OF UNCONTESTED FACTS

The parties have agreed that the following statements are not contrary to fact. However, the parties are not in agreement regarding the relevance and materiality of all the facts set forth below. Therefore, objections, if any, will be indicated parenthetically following the paragraph(s) in question.

Abbreviations will be used as follows:

GD — Governmental Defendants
C — Citizens
H — Hutchinson
R — Relevancy

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* Included in this Appendix are the uncontested facts set forth in the Joint Final Pretrial Report incorporated by Judge Shabaz in the District Court's Memorandum Decision dated August 18, 1987. See A.13. The remainder of the Joint Final Pretrial Report has not been reprinted here.

EDA GUARANTY CLAIMS

1. Plaintiff, Citizens Marine National Bank ("Citizens"), is a banking institution maintaining its principal place of business at 1045 Main Street, Stevens Point, Wisconsin 54481.

2. Defendant, United States Department of Commerce, Economic Development Administration ("EDA"), is an agency of the United States Government with its central and principal office at the Department of Commerce, 14th Street at Constitution Avenue N.W., Washington, D.C.

3. Defendant, Malcolm Baldridge, was the Secretary of Commerce ("Secretary") at the time this action was commenced.

4. Defendant, United States of America, is an indispensable party to this action.

5. Defendant, Weber Tackle Company, is a Wisconsin manufacturing business corporation with its principal office and place of business located at 1039 Ellis Street, Stevens Point, Wisconsin. Weber Tackle Company is no longer in operation.

6. Defendant, Weber Plastics, Inc., is a Wisconsin manufacturing business corporation with its principal office and place of business located at 1039 Ellis Street, Stevens Point, Wisconsin. Weber Plastics, Inc. is no longer in operation. Unless otherwise noted, Weber Tackle Company and Weber Plastics, Inc. will be referred to as "Weber."

7. Defendant, Remer Hutchinson, is an adult resident of the State of Wisconsin, the president of Weber Tackle Company and Weber Plastics, Inc. and the owner of sufficient shares of the issued and outstanding capital stock of Weber Tackle Company and Weber Plastics, Inc. to have voting control.

8. Defendant, Elaine Hutchinson, is an adult resident of the State of Wisconsin, the wife of Remer Hutchinson, and is a former secretary of Weber Tackle Company and Weber Plastics, Inc.

9. During 1979, Weber approached Citizens requesting a loan for financing operations of Weber's fishing tackle and plastic products manufacturing facility and a loan for purchasing new equipment and modernizing existing equipment used in Weber's fishing tackle and plastic products manufacturing operations. Because of the unsatisfactory credit history and large debt of the company, Citizens, as well as other area banks, determined that they would not loan Weber the requested funds. (GD-R)

10. On or about October 16, 1979, Weber submitted its Petition for Certification of Eligibility to apply for Trade Adjustment Assistance under and pursuant to Chapter 3 of Title II, Section 251 of the Trade Act of 1974 [pub. L. 93-618] and § 315.23 of the Adjustment Assistance Regulations for Firms and Communities [13 C.F.R. part 315].

11. Consequently, the United States Department of Commerce initiated an independent investigation to determine whether increased imports into the United States of articles like or directly competitive with those produced by Weber contributed importantly to a total or partial separation of Weber's workers, (i.e., a reduction in Weber's employees) or the threat of such separation, and to a decrease in the sales or production of Weber. (GD-R)

12. Weber's Petition for Certification of Eligibility to apply for Trade Adjustment Assistance was submitted to and accepted by Jack W. Osborne, Jr., Chief of the Trade Act Certification Division, Office of Eligibility and Industry Studies, Economic Development Administration, Department of Commerce. With respect to Weber's

Petition for Certification of Eligibility, the Trade Adjustment Assistance eligibility examiner found as of December, 1979, among other things, the following: that Weber's sales had decreased absolutely; that a significant portion of Weber's workers had become totally separated; that imports of articles considered "like or directly competitive with" the articles produced by Weber had increased absolutely; that the increased imports of articles like or directly competitive with articles produced by Weber contributed importantly to the declines in Weber's sales and to the separation of a significant proportion of Weber's employees; and that no information was developed or obtained that was inconsistent with a finding that United States imports of like or directly competitive articles contributed importantly to the decline in Weber's sales and employment. (GD-R)

13. On or about December 28, 1979, Weber's Petition for Certification of Eligibility was accepted, and a "Certificate of Eligibility to apply for Trade Adjustment Assistance" was issued to Weber by the EDA. (GD-R)

14. On or about October 16, 1980, Weber submitted its application to the EDA for financial assistance from the U.S. Department of Commerce, Economic Development Administration Trade Adjustment Assistance Program.

15. During the period of June through November, 1980, Weber experienced a labor strike caused by, among other things, a disagreement between management and labor over contract terms, including wages and employee benefits.

16. Because the EDA did not consider Weber's application for Trade Adjustment Assistance during the strike, the application process was delayed during this period of time. The strike was settled in late November, 1980.

17. The EDA and the Midwest Trade Adjustment

Assistance Center ("Midwest TAAC"), who assisted Weber with Weber's application for a loan guaranty under the Trade Adjustment Assistance Program (see fact number 20 below), were aware of the labor strike at Weber. (GD-R)

18. Weber employees, union representatives as well as Weber management wrote letters to the EDA and to Midwest TAAC expressing concern over the tactics being used by the other side, including their belief that each side was using the delay in the EDA Loan Guaranty application process as unfair leverage during the strike negotiations. (GD-R)

19. The Trade Act of 1974 Adjustment Assistance Loan Guaranty application process is set forth and governed by specific statutory requirements and regulations set forth in Title 19 U.S.C. §§ 2341 et seq. and 13 CFR Part 315.

20. As a necessary step in the EDA Loan Guaranty application process, and with assistance of the Illinois Institute of Technology through Midwest TAAC representatives, Weber and Midwest TAAC prepared and submitted a voluminous Diagnostic Analysis and Recovery Plan ("Recovery Plan"). (GD-R)

21. Midwest TAAC was under contract with the EDA and was paid by the EDA for Midwest TAAC's services in analyzing and preparing Weber's Recovery Plan. The basic funding for Midwest TAAC was from the Government through the EDA. There was a 25% local share that Midwest TAAC itself was responsible for pursuant to EDA's cost-share guidelines for technical assistance under the Trade Adjustment Assistance program. (GD-R)

22. In November of 1980, Midwest TAAC indicated to Citizens that Midwest TAAC was confident of Weber's future potential based upon Midwest TAAC's research and planning.

23. As part of the Recovery Plan preparation,

Midwest TAAC undertook an evaluation of Weber's management capability and concluded that Weber's management was capable of turning the company around. These conclusions are set forth in greater detail in the Recovery Plan. (GD-R)

24. Generally, Midwest TAAC did not rely upon the lending institution involved or solicit opinions from the lending institution when preparing the Diagnostic Analysis and Recovery Plan. Rather, Midwest TAAC would deal directly with the borrower and with the EDA officials involved. (GD-R)

25. With respect to the Weber Recovery Plan, Midwest TAAC had little contact with Citizens, and did not solicit Citizen's opinions with respect to the information and analysis set forth in the Recovery Plan. (GD-R)

26. Staff personnel at Midwest TAAC, including Sam Carmickle, visited the Weber facilities on several occasions to obtain information in order to prepare the Recovery Plan. During Midwest TAAC's visits to Weber's Stevens Point facilities, Midwest TAAC consulted with Weber's management in order to make sure that the projections and suggestions Midwest TAAC was considering were coordinated with Weber's management. (GD-R)

27. Midwest TAAC undertook an analysis to determine the market for Weber's products, and, based upon the market study, proceeded accordingly to prepare the Recovery Plan and develop an overall recovery strategy. (GD-R)

28. After an initial final draft of the Recovery Plan was completed and provided to the EDA for review, a draft was also provided to Citizens. A determination was made by Citizens at that time that the Recovery Plan needed additional work and revision. After Citizens suggested certain revisions to the EDA and Midwest TAAC, the Recovery Plan was then revised by Midwest

TAAC to the satisfaction of the EDA.

29. Citizens had determined the initial Recovery Plan prepared by Midwest TAAC needed revisions because, among other reasons, the Recovery Plan did not provide enough working capital funds. Such revisions were necessary as a result of, among other things, the delay involved since the time the application was submitted.

30. Midwest TAAC believed that the Recovery Plan was a viable Plan.

31. The EDA reviewed the proposed final Recovery Plan submitted by Midwest TAAC and Weber to make sure the Recovery Plan had all the components the EDA needed in order to evaluate the application for Trade Adjustment Assistance.

32. The final revised Recovery Plan, as required by Title 19 U.S.C. § 2341 et seq., was completed and accepted by the EDA as part of the Trade Adjustment Assistance Loan Guaranty application prior to EDA offering, and Citizens accepting, the EDA guaranty agreements.

33. In the final revised Recovery Plan "Weber Industries" is stated or mentioned 32 times in the text of the analysis and on the financial data sheets forming the basis of the Recovery Plan. The name Weber International is also mentioned in the Recovery Plan.

34. In connection with Weber's application to the EDA for loan guaranties made under the authority of Title 2, Chapter 3 of the Trade Act of 1974, and as required by Title 19 U.S.C. § 2341 et seq., the EDA performed an analysis and made the following required findings, among others, as set forth in one EDA document dated in March of 1981 and signed by Kathryn Huth, one of EDA's financial analysts and Charlene Degan, counsel for EDA's regional office.

a. That Weber's application for Assistance included a proposal for the economic adjustment of the

firm (the Recovery Plan);

b. That Weber's economic adjustment proposal demonstrated, among other things, all of the following:

(i) that the assistance sought would aid Weber to establish a competitive position in the same or a different industry;

(ii) that adequate consideration was given to the interests of the workers of Weber adversely effected as a result of the serious economic injury to Weber caused by imports;

(iii) that Weber would make maximum use of its own resources for economic development;

(iv) that any funds requested were not otherwise available to Weber, from sources other than the federal government, on reasonable terms;

(v) that Weber had no reasonable access to financing through the private capital market;

(vi) that there was evidence of unavailability of other financing, including letters from two qualified financial instututions in the Stevens Point area who refused to provide Weber with financial assistance; and

(vii) that Weber provided evidence that Citizens would not assist in the project financing, i.e., make the loans, without the EDA guaranties;

c. That the funds required were not available from Weber's own resources;

d. That there was a reasonable assurance of repayment of the loans for which the guaranties were sought.

The document setting forth these findings, among other things, is attached as *Exhibit A*.

35. Before the Weber loans and guaranty agreements were closed on December 17, 1981, the Recovery Plan

was determined to be a viable Recovery Plan and acceptable to the EDA after an EDA review.

36. Prior to closing the Weber loans and guaranty agreements, it was determined by Midwest TAAC, to the satisfaction of the EDA, that Weber's management was capable to pursue and obtain goals and objectives of the final Recovery Plan.

37. EDA personnel performed an analysis and made a determination that the Final Recovery Plan was viable and that Weber's management was capable to carry out the Recovery Plan.

38. On or about August 27, 1980 Weber International, Inc. was formed and incorporated in the State of Wisconsin by Remer and Elaine Hutchinson. Hutchinson originally intended to merge Weber Tackle and Weber Plastics, Inc. into Weber International, Inc., so that the surviving company would do business under the name of Weber International, Inc. The first choice for the name of the surviving company was "Weber Industries," but that name had been previously reserved on behalf of a company in the LaCrosse, Wisconsin area. The EDA was aware of the contemplated merger with Weber International and the EDA was aware of the existence of the name Weber International, Inc.

39. The processing and approval of Weber's applications for Trade Adjustment Assistance from the EDA involved a period of almost 2 years.

40. When the time came to go through with the Weber International merger, Hutchinson discovered that going ahead with planned merger would require the entire EDA guaranty application process be started over again. The merger plan was then abandoned.

41. As of March, 1985, Weber International had not merged with nor become a subsidiary of any other corporation. As of March, 1985, Weber International has

not acquired or taken control over any other corporations.

42. During the application processing period Weber International was a name used in correspondence, conversations and on financial data sheets shared between Citizens, Hutchinson and the EDA.

43. Weber used company stationary and related items, including company checks, with the name Weber International on them. These checks were printed with the same checking account number as Weber Tackle Company's and Weber Plastics Inc.'s checking account. The names Weber Tackle Co., Weber Plastics and Weber International were used by Weber and its customers.

44. Ken Schmidt, the loan officer at Citizens handling the Weber loans and guaranties, had telephone discussions with Kathryn Huth, the EDA financial analyst responsible for processing Weber's application for an EDA loan guaranty, regarding Weber International, Inc. and the contemplated merger.

45. Prior to and at the closing of the Weber loans and guaranty agreements, the EDA was informed of and was aware that Hutchinson controlled approximately 80% to 85% of the outstanding stock of Weber Tackle Company.

46. The EDA, including Edward Jeep, Regional Director of the EDA, Kathryn Huth, and Charlene Degan, EDA's regional counsel, was aware of Hutchinson's 80% stock pledge and the Weber loans and guaranty agreements were closed with the knowledge of this fact.

47. In a telephone conversation between Kathryn Huth and Ken Schmidt, Ms. Huth indicated that a 1% loan origination fee could be charged by Citizens. Ms. Huth indicated that the fee could be paid over the course of 1 year on a quarterly basis.

48. An EDA "Action Memorandum" (July 22, 1981) recommending approval of Weber's application was

prepared by EDA loan officer and financial analyst Kathryn Huth, and was cleared by or routed through at least the following: J.L. Gibson, Acting Chief of the EDA Business Development Division, Charlene Degan, EDA's counsel in the Chicago regional office, Edward G. Jeep, the EDA Regional Director in Chicago, and others indicated by initials on that document.

49. On or about September 18, 1981, Harold W. Williams, Acting Assistant Secretary for Economic Development of the EDA, approved the recommendation of Edward Jeep, Regional Director of the EDA, that the EDA approve Weber's application and guaranty the proposed fixed asset loan and working capital loan from Citizens to Weber.

50. On or about September 18, 1981, pursuant to the EDA Trade Adjustment Assistance Program, the EDA offered to enter into a Guaranty Agreement ("Working Capital Guaranty") with Citizens. Pursuant to the Working Capital Guaranty, which was authored by EDA personnel and signed by Citizens, the EDA agreed to pay Citizens ninety percent (90%) of the total principal and interest owing to Citizens in the event of default by Weber under the working capital loan pursuant to the terms and conditions of the guaranty.

51. On or about September 18, 1981, pursuant to the EDA Trade Adjustment Assistance Program, the EDA offered to enter into a Guaranty Agreement ("Fixed Asset Guaranty") with Citizens. Pursuant to the Fixed Asset Guaranty, which was authored by EDA personnel and signed by Citizens, the EDA agreed to pay ninety percent (90%) of the total principal and interest owing to Citizens in the event of default by Weber under the fixed asset loan purusant to the terms and conditions of the guaranty.

52. On or about September 24, 1981 Citizens accepted EDA's offer of the Working Capital Guaranty and the

Fixed Asset Guaranty.

53. On or about December 17, 1981, Edward Jeep, Regional Director of the EDA, indicated by letter to Citizens that the EDA had reviewed the closing documents and found that all conditions precedent and requirements to closing, as well as the initial disbursements of the guarantied loans, had been met and that the EDA guaranty agreements were in full force and effect.

54. On or about December 17, 1981, the Weber loans and guaranty agreements were closed. Among others, Kathryn Huth, Charlene Degen, Remer Hutchinson and Ken Schmidt were present.

55. At the closing, the EDA approved the interim advances and the initial disbursements on the Weber loans.

56. Interim advances were made to Weber during the time that Weber's application for Trade Adjustment Assistance was pending with the EDA. These interim advances in the amount of $435,000 were advanced through participating banks Wood County National Bank and The Commercial Bank in Chilton. The initial disbursements and the allowable uses for the initial disbursements are set forth in the guaranty agreements and were approved by the EDA at the closing of the Weber loans.

57. The proceeds of the initial disbursement on the working capital loan, as set forth in the Working Capital Guaranty, were to be used to pay off or otherwise reduce the obligations of Weber specified in the guaranty agreement.

58. Pursuant to the Working Capital Guaranty, the working capital loan was to be used for the purpose of financing the operations of Weber's fishing tackle and plastic products manufacturing facility. The definition

of working capital expenses for which the working capital loan funds were to be used is set forth in the Working Capital Guaranty.

59. Pursuant to the Fixed Asset Guaranty, the fixed asset loan was to be used for the purpose of purchasing new equipment and modernizing existing equipment in Weber's fishing tackle and plastic products manufacturing operations. The fixed asset loan funds were to be used as set forth in the fixed asset categories included in the Recovery Plan.

60. Under the terms of the loan agreement between Weber and Citizens, working capital advances and fixed asset advances made from time to time were to be evidenced by a series of promissory notes issued by Weber Tackle Company to Citizens contemporaneously with the loan disbursements.

61. Pursuant to the loan agreement between Weber and Citizens, and commencing December 18, 1981 and continuing through September 24, 1982, Citizens made a series of eighteen (18) working capital advances totalling $1,210,500 to Weber. Of this amount, $435,000 went to participating banks for funds advanced to Weber International by those participating banks during the application process period (the interim advances).

62. The Working Capital Guaranty provided that Citizens should obtain from Weber sufficient documentary information of disbursement use before making disbursements of working capital loan funds.

63. With respect to the working capital loan disbursements, Weber was reimbused by disbursement of loan funds based upon the certification of Weber's president, Remer Hutchinson, on behalf of Weber, that such funds were being used for working capital purposes as that term is defined in the loan and guaranty agreements. A requisition form was used for this purpose.

64. Citizens did not require Weber to submit, prior to disbursement, specific documentation other than the requisition form certification that the funds were needed and being used for working capital purposes as that term is defined in the Working Capital Guaranty.

65. Citizens required certification from Weber that working capital loan disbursements were used for authorized working capital purposes. Citizens relied in part upon the credibility of Mr. Hutchinson when he certified that the funds were being used according to the authorized purposes in the loan and guaranty documents.

66. Prior to disbursement of the fixed asset proceeds, Weber provided Citizens with a requisition form and, in addition, written schedules of the specific uses for the disbursement requests made together with copies of the invoices attached. Citizens then ascertained whether the request for disbursements was made in accordance with the requirements of the Fixed Asset Guaranty.

67. Under the disbursement procedure followed by Citizens and Weber, Weber would purchase or otherwise incur the expense for the fixed asset purchase and then attach copies of the invoices to the disbursement requisition forms. Citzens would then review the expenditures to determine the suitability of reimbursement.

68. The loan disbursements were always deposited directly by Citizens into the checking account at Citizens used by Weber Tackle Company and Weber Plastics, Inc. This checking account was also maintained in the name of Weber International, Inc., although prior to March, 1985, Weber International, Inc. was not an operating business or a going concern. In March, 1985, subsequent to the time that Citizens stopped disbursing loan funds to Weber, Weber International operated as more than just a corporate shell.

69. All of the working capital and fixed asset funds were disbursed directly into the same checking account

at Citizens.

70. During the pendency of the Weber loans, Weber maintained a negative balance in its checking account during certain periods.

71. Some of the proceeds of the EDA guarantied loans were used to pay interest on the SBA loan, as well as interest on Weber's other debt.

72. Citizens and the EDA were in frequent contact both prior to and subsequent to the closing of the Weber loans and guaranty agreements.

73. Citizens provided the EDA with information and documents throughout the course of the loans. Communications between the EDA and Citizens consisted of telephone conversations, written correspondence and personal contacts.

74. Citizens' primary contacts with the EDA included the financial analysts or loan officers employed by the EDA who were responsible for monitoring and servicing[1] the Weber project loans and guaranty agreements on behalf of the EDA. Such individuals included Kathryn Huth (pre-closing through approximately July of 1982) and Wayne Schroeder (July of 1982 through approximately January of 1984), of the EDA's Chicago office, and Rudy Grandinetti (January of 1984 through approximately February of 1985) and Joseph Rusciano (February of 1985 through January 31, 1986) of the EDA's Washington D.C. office.

75. Citizens received monthly financial statements

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[1] The governmental defendants are concerned with the use of the term "servicing." Citizens was responsible for servicing the Weber loans under the guaranty agreements. The EDA was responsible for servicing the Weber loans within the Federal government pursuant to the applicable statutes, regulations, departmental policies and guidelines.

from Weber from 1981 through the time Weber ceased operations, as well as annual audited statements prepared by accounting firms retained by Weber. The monthly financial statements were sent to the EDA by Citizens on a quarterly basis for EDA's review. All of the annual audited statements were sent to the EDA.

76. When the annual audited statements were provided to Citizens by the accountants, Citizens reviewed them and forwarded the annual audited statements to the EDA. At that point, the financial analysts for the EDA performed an analysis and review for compliance with the guaranty agreements.

77. Citizens sent the EDA periodic financial information, reports, projections, etc., including information contained in quarterly report forms provided by the EDA and identified as "ED-700" forms. These ED-700 forms, among other things, provided the EDA with information regarding the status of the Weber loans, including the amount of advances made for each loan during the prior quarter.

78. Weber defaulted on the working capital loan and the fixed asset loan by failing to make the payments required on or by October 18, 1982.

79. Weber defaulted under all of the working capital notes and fixed asset notes by failing to pay any of the monthly principal and interest installments due subsequent to October 18, 1982.

80. Citizens notified the EDA promptly of the defaults by Weber by letter to the EDA dated October 28, 1982. Citizens' notification to the EDA was acknowledged by EDA Regional Director Edward Jeep in a letter he sent

to Citizens addressed to Ken Schmidt and dated November 23, 1982.

81. After Weber's default on the loans, Ken Schmidt had periodic conversations with Wayne Schroeder regarding, among other things, Weber's defaults on the loans.

82. Every quarterly ED-700 form report from October, 1982 forward, all of which were sent to the EDA by Citizens, indicate the default status of the loan. These reports also show that loan advances were made and indicate the past due dates and balances. The EDA was notified and was aware of loan disbursements to Weber while the loan was in a default status.

83. At least as of November 23, 1982, the EDA had noted and was aware of the fact that Weber was in violation of certain of the negative covenants of the guaranty agreements.

84. On or about December 9, 1982, Ken Schmidt, in a letter addressed to Wayne Schroeder, requested EDA's guidance or input regarding what actions Citizens should take to rectify the negative covenant violations.

85. In a letter dated April 1, 1983, from Kenneth Schmidt to Wayne Schroeder, Citizens transmitted the quarterly ED-700 forms to the EDA. Also, the EDA was informed that Citizens had attempted to cure the violations of the negative covenants but that Citizens had been unsuccessful. At that time, Citizens could not justify waiver of the violations and indicated to the EDA that Citizens was open to suggestions.

86. Weber applied for certification for the Small Business Administration's 8(a) minority set-aside contract program in early 1983 and the certification was approved by the SBA on or about October 7, 1983. It was hoped that the 8(a) certification would allow Weber

to increase sales volume by obtaining subcontract work on government contracts.

87. In May 1983, Ken Schmidt informed Wayne Schroeder, among other things, that Citizens had not received any loan payments that spring because of lower than anticipated seasonal sales. Schmidt further advised Schroeder that Citizens was continuing to make new advances.

88. On two occasions during the course of the Weber loans, a request was made to the EDA by Weber to modify the guaranty agreements in order to allow a transfer of loan funds from the fixed asset category to the working-capital category. The first such request was made in October of 1982. This request was directed to the attention of Wayne Schroeder, the financial analyst in the EDA's Chicago regional office who was responsible for servicing and monitoring the Weber project on behalf of the EDA.

89. On November 8, 1982, Wayne Schroeder indicated in a telephone conference with Ken Schmidt that a decision on the modification request could not be made at the regional level. Mr. Schroeder indicated that EDA's Washington office would be consulted.

90. Wayne Schroeder notified Citizens by telephone on November 16, 1982 that the EDA could not approve the modification request. By letter dated November 23, 1982, the EDA, by Edward Jeep, notified Citizens that the EDA denied the request for modifying the Weber loans.

91. A second modification request was made on or about May 11, 1983, and was directed to the attention of Wayne Schroeder by letter from Kenneth Schmidt. This modification request would have modified the loan agreements and would authorize capital expenditures in areas other than those originally approved.

92. The Chicago regional office of the EDA initially evaluated the modification request. As part of the EDA's evaluation, Wayne Schroeder made a field visit to Weber in Stevens Point.

93. The EDA regional office suspended any decision on the modification request until specified field visit questions were answered:

> a. Why is lender carrying loan? Are they acting as a prudent lender providing proper surveillance of loan?
>
> b. What is their recovery work-out plan?
>
> c. Is other long-term current including SBA?
>
> d. Any negative covenant violations?

94. Wayne Schroeder then prepared a field visit report indicating support for the recommendation to proceed with the modification to the Weber loans requested by Weber and Citizens.

95. Wayne Schroeder's notes of his field visit to Stevens Point state in part as follows: "Bank adequately servicing loan." Mr. Schroeder's notes also indicate that the SBA 8(a) certification would be the key to Weber's recovery. Further, Mr. Schroeder indicated in his notes that Remer Hutchinson was optimistic at this point that Weber would turn around, but that Ken Schmidt at Citizens was only guardedly optimistic.

96. The EDA regional office, through Donald Goostrey, Chief Business Loans Division of the Chicago regional office of the EDA, and Edward G. Jeep, Regional Director of the EDA, recommended to the EDA's Washington, D.C. office that Weber's modification request be approved. The recommendation was made in an Action Memorandum dated November 14, 1983.

97. The EDA office in Washington, D.C. denied the modification request in January of 1984. Citizens was notified of the denial of the modification request by the EDA on or about April, 1984.

98. By letters dated May 11, 1983, July 7, 1983, August 17, 1983, September 13, 1983, October 4, 1983, October 11, 1983, November 10, 1983, and December 7, 1983, Citizens transmitted and provided the EDA with documents and information, including numerous financial statements, reports and the quarterly ED-700 form. These letters also refer to and inquire about the modification request. In addition, Weber's 8(a) certification from the SBA was discussed.

99. By letters dated January 4, 1984, February 3, 1984 and February 28, 1984, Citizens transmitted and otherwise provided EDA with documents and information with respect to the Weber loans and guaranty agreements. These letters also referred to the modification request pending since March of 1983.

100. The annual audited statements for the year ending July 31, 1983, were received by the Bank in November, 1983. These statements indicated that Weber's current ratio had become less than 1.2 to 1.0. The EDA was sent copies of these annual audited statements.

101. In December, 1983 Citizens made the decision not to advance any more loan funds to Weber. This decision was based upon, among other things, the continued deterioration of Weber's financial condition.

102. On or about January 24, 1984, the EDA files relating to the Weber loan guaranties were transferred from the Chicago regional office of the EDA to the EDA office in Washington, D.C. for monitoring and servicing.

103. In connection with the transfer of the EDA files from the Chicago office to the Washington office, a

"Transfer Report" was prepared by Wayne Schroeder, Donald Goostrey and Edward Jeep. This Transfer Report set forth the history of the Weber loans up through the time of transfer.

104. Citizens demanded, on or about June 15, 1984, that the EDA honor its guaranty commitments and repurchase the EDA guarantied portion of the loans. The demand was made in a letter dated June 15, 1984 from Ken Schmidt to Rudy Grandinetti.

105. Both prior to and subsequent to Citizen's demand upon the EDA to honor its guaranty obligations Citizens continued to supply the EDA with documents and information regarding the Weber project and loans.

106. Subsequent to Citizens' demand upon the EDA to purchase the guarantied portions of the Weber loans, and by the end of September, 1984, Citizens provided the EDA with documents/information requested by the EDA, including two separate EDA requests for documents set forth in correspondence dated July 12, 1984 and August 28, 1984 from Rudy Grandinetti, Financial Analyst in the EDA Office of Liquidation in Washington.

107. The EDA did not commence its review of the documents Citizens sent to the EDA after demand was made until February of 1985.

108. By letter dated November 2, 1984, Citizens requested that the EDA provide Citizens with approval to accelerate and declare immediately due all amounts due and owing Citizens and/or the EDA from Weber Tackle Company.

109. On or about November 13, 1984, the EDA, by letter from James Marx, concurred with Citizens' request to accelerate the maturity of the notes and make demand upon the guarantors. The EDA sent an additional letter providing the same information on November 15, 1984.

110. On or about November 26, 1984, Ken Schmidt had a telephone conversation with Rudy Grandinetti of the EDA. Mr. Schmidt and Mr. Grandinetti agreed that it would be prudent at that time to hold off the acceleration and demand on Weber's debt because, among other things, Citizens' legal counsel was out of town at that time and because the City of Stevens Point was very interested at that time in purchasing Weber's building to use as a new library facility. (GD-R).

111. By letter dated January 10, 1985, Citizens, among other things, reiterated its offer to visit EDA's legal department to discuss any remaining questions regarding the documentation of the Weber loans. This letter also discussed additional potential SBA 8(a) contracts. (GD-R)

112. On February 5, 1985, Citizens wrote to Mr. Travis Dungan, then Deputy Assistant Secretary for Finance, Department of Commerce, Economic Development Administration, to request his assistance in resolving the EDA's delay in honoring the Weber loan guaranties. (GD-R)

113. About this time, the EDA assigned a new financial analyst or account officer, Joe Rusciano, to the Weber project. Citizens then communicated at various times with Michael Oberlitner, Acting Director, Office of Liquidation, Travis Dungan and Joe Rusciano of the EDA in Washington, D.C.

114. Citizens accelerated all delinquent outstanding debt and made demand upon Weber on or about March 11, 1985.

115. In March of 1985, Weber ceased operations.

116. During this period, the EDA continued making requests for Citizens to provide additional documentation.

117. By letter dated April 17, 1985, the EDA indicated that it was now prepared to make a final determination regarding payment on the Weber loan guaranties. Also, the EDA forwarded certain documents intended for execution at or prior to the closing of the EDA's repurchase of the guaranties, including the Subordination Agreement and the Lender's Certification to Guarantor. That letter, signed by Michael Oberlitner, suggested a three-way meeting between the EDA, the SBA and Citizens to determine "first-hand the options for conducting Weber's liquidation" and also suggested that a closing be scheduled in Washington, D.C. regarding the EDA's purchase of 90% of the loans and finalization of a strategy for conducting a liquidation of the account.

118. On or about April 25, 1985, Citizens met with Joe Rusciano of the EDA, Earl Koch and others of the SBA, and Gary Reber of the Internal Revenue Service, among others, regarding possible strategies for the liquidation of the Weber loans. Subsequent to that meeting, Citizens drafted a proposal for liquidation and submitted that proposal to the EDA and the SBA.

119. In May of 1985, the Office of Inspector General, ("OIG") Department of Commerce, commenced a preliminary audit of the Weber loans. The OIG auditors involved were John Christian and John Bishop. (GD-R)

120. As a result of the OIG's preliminary audit, certain issues regarding the Weber account were brought to Citizens' attention. (GD-R)

121. In a letter dated May 23, 1985, from Citizens to Mr. John Bishop of the OIG, Citizens addressed certain issues raised by the OIG. (GD-R)

122. On or about May 28, 1985, Citizens, in a letter addressed to Michael Oberlitner of the EDA, referred to, among other things, the possible removal of collateral

from the Weber premises by Weber's president, Remer Hutchinson.

123. By letter dated June 7, 1985, the EDA, through Michael Oberlitner, informed Citizens that the OIG was now going to conduct a detailed audit addressing the bank's administration of the loan and Weber's use of the loan proceeds. (GD-R)

124. One of the issues in this litigation which was also raised by the OIG involved a negative covenant in the guaranty agreements which provided for a limit on the salary of Weber's president. The Working Capital and Fixed Asset Guaranty each provide that Citizens require Weber to agree that the maximum annual salary for Weber's president was not to exceed $30,000.00. Citizens obtained Weber's agreement, in the executed loan agreements, to abide by this requirement.

125. Weber paid its employees' salaries, including the president's annual salary from funds available in its account at Citizens.

126. During 1982 Citizens was not aware of and did not suspect any violation of the maximum annual salary limit.

127. Violations of the maximum annual salary limit are not listed in any of the annual audited statements as violations of the loan agreements or loan guaranty agreements. The annual audited statements were prepared by accounting firms and were sent to the EDA.

128. In April, 1983, after a review of one of Remer Hutchinson's paychecks, Ken Schmidt suspected a violation of the maximum annual salary limit and he attempted to but did not confirm the violation. Schmidt confronted Hutchinson and attempted to but did not obtain a W-2 form to confirm whether or not a violation had taken place. The salary of Hutchinson continued to

be paid out of Weber' account at Citizens after April of 1983.

129. With respect to the alleged 1984 $6000 salary limitation violation, Citizens was unable to confirm a salary violation.

130. Another issue raised in this litigation which was also raised by the OIG involved certain payments from Weber to its president which violated the negative covenants in the guaranty agreements. It is indicated in the annual audited statements that Weber paid a certain amount of its funds to Weber's president. Citizens attempted to remedy this violation and notified the EDA of the payment.

131. A payment of $10,833 was noted by the accountants in the 1982 annual audited statements, and a payment of $1,480 was noted by the accountants in the 1983 annual audited statements as violations of the "Economic Development Administration Loans." The 1982 and 1983 annual audited statements were sent to the EDA. The EDA had knowledge of this matter.

132. One of the issues raised in this litigation and which was also raised by the OIG involves at least $60,000 of the proceeds of Weber's accounts being deposited with another bank to prevent Citizens from reaching those proceeds. Weber opened an account at First Financial Savings and Loan on or about April 12, 1985. When Citizens learned about this account, action was taken to require Weber to correct this diversion of proceeds. Within a short time after Citizens learned of the separate account, that account was closed on or about July 9, 1985 and the diversion of proceeds ceased.

133. On or about June 17, 1985, during the time Weber had diverted funds to an account with First Financial, a $30,936 payment was drawn on that account payable

to Weber International. The $30,936 payment to Weber International, Inc. was a payment to Weber International on a subcontract pursuant to a SBA 8(a) contract awarded to Weber Tackle. At this point, Weber International, Inc. became a small operation in New London, Wisconsin. Although there was a $30,936 payment on the subcontract to Weber International, Weber Tackle recovered this amount as part of the receivable on the 8(a) contract involved.

134. After learning of the possible removal of equipment and collateral from Weber's principal place of business, Citizens confronted Weber's president who initially refused to cooperate or return the equipment. However, the collateral was eventually returned without incident and without economic detriment to Citizens or the EDA.

135. By letter dated June 10, 1985, Citizens notified the EDA that Citizens intended to proceed with foreclosure actions against Weber.

136. By letter dated November 22, 1985, from Citizens to Joe Rusciano of the EDA, Citizens provided the EDA with the analysis performed by Citizens, dated December 9, 1981, regarding Citizens' summary of the Weber indebtedness prior to making the EDA guarantied loans on December 17, 1981.

137. The EDA, by letter dated February 20, 1986, refused to acknowledge liability on its guaranty agreements.

138. During the pendency of the EDA guarantied Weber loans Citizens has been a national bank operating under the auspices of the Comptroller of Currency.

139. In March of 1986, the Marine Corporation formally purchased the stock of Citizens. Citizens is currently part of the Marine corporation. (C-R)

140. As of August 13, 1987, there will be due and owing

on the working capital loan $1,210,500.00 in principal and $730,351.83 in interest, or $1,940,851.83 in total.[2]

141. As of August 13, 1987, there will be due and owing on the fixed asset loan $738,896.63 in principal and $426,358.55 in interest, or $1,165,255.18 in total.

142. As of August 13, 1987, the total amount of principal and interest on the EDA guarantied loans to Weber will total $3,106,137.01, ninety percent of which is $2,795,523.31.

143. As of August 13, 1987, Citizens has expended and been awarded in its judgment of foreclosure $50,000.00 in attorneys' fees and $91,060.34 in disbursements in pursuing the foreclosure of Weber's real property and replevin and immediate possession of Weber's personal property.

144. As of August 13, 1987, Citizens will have expended additional sums in maintaining and preserving the value of the Weber real estate and other collateral, including expenses for security, utilities, taxes, legal and miscellaneous costs.

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[2] Stipulation as to the exactness of the number and calculations in this report remain subject to verification by the governmental defendants.

145. As of August 13, 1987, Weber's other outstanding indebtedness to Citizens is set forth below:

	Principal	Interest	Total
Refinanced	$125,000.00	$ 77,061.63	$202,061.63
Notes:	157,727.28	97,237.76	254,965.04
	223,798.84	137,970.39	361,769.23
	255,000.00	133,131.25	388,131.25
Uncollected SBA	121,300.00	61,170.58	182,470.58
TOTAL:			$1,389,397.68

(GD-R)

* * *

Respectfully submitted this 7th day of August, 1987.

WHYTE & HIRSCHBOECK S.C.
Attorneys for Plaintiff

By: /s/K. Michael Cooley
Peter L. Gardon
K. Michael Cooley

UNITED STATES ATTORNEY
FOR THE WESTERN DISTRICT
OF WISCONSIN
Attorneys for the
Governmental Defendants

By: JR/s/
James C. Ratzel
Assistant U. S. Attorney

**Project Office Kathryn Huth 3/17/81*
Legal Concurrence Charlene Degen 3/20/81

Weber Tackle
Project No. 06-44-00034, 06-44-00035

Loan Guarantees Made Under the Authority of Title II, Chapter 3 of the Trade Act of 1974

Findings:

Instructions: Each item contains a statement of a project requirement which must be satisfied before a project can be approved. A finding that the requirement has been satisfied should be indicated by inserting "Yes" in the column on the right. For each satisfactory finding, identify its source and location in the Project File. If a requirement has not been satisfied, insert "No" in the column and attach an explanation. If a requirement is not applicable, insert "NA".

	Requirement Satisfied
1. The applicant is eligible for assistance	
(a) applicant is certified as eligible for assistance (§251)	*Yes*
(b) application for assistance is made within two years of date of certification (§252(a)) *(certified 12-28-79)*	*Yes*
(c) applicant is a firm as defined by §261 (individual proprietorship, partnership, joint venture, association, corporation (including a development corporation) business trust, cooperative, trustee in bankruptcy, and receiver under decree of any court)	*Yes*
Source: *certificate of eligibility application - ED-201* Location: *Tab A*	

* The italicized print represents hand-written notes inserted by the EDA author(s).

	Requirement Satisfied
2. Application for assistance includes a proposal for the economic adjustment of the firm (§252(a)) Source: *adjustment plan* Location: *file*	*Yes*
3. Firms' economic adjustment proposal demonstrates all the following: (13 CFR 315.20(b); 252 (b)(1)(B))	
(a) the assistance sought will aid the firm to establish a competitive position in the same or a different industry	*Yes*
(b) adequate consideration is given to the interests of the workers of the firm adversely affected as a result of the serious injury to the firm	*Yes*
(c) the firm will make maximum use of its own resources for economic development	*Yes*
(d) any funds requested are not otherwise available to the firm, from sources other than the Federal Government, on reasonable terms	*Yes*
(e) the firm has no reasonable access to financing through the private capital market (§252(b) (1) (A))	*Yes*
(f) evidence of unavailability of other financing: (13 CFR 315.20(b); 13 CFR 306.8)	

	Requirement Satisfied
(1) letters from two qualified financial institutions in the area refusing assistance ☒ (or 2) if only one qualified financial institution in the area, letter from it refusing assistance ☐ (or 3) if no qualified institutions in the area, certification by the applicant to this fact ☐	*Yes*
(g) applicant provides evidence that the lending institution making the loan would not assist in the project financing without the EDA guarantee (13 CFR 306.8(c))	*Yes*
(h) where loan for which guarantee is sought will be used for working capital purposes, loan is not secured by a prior lien on the same assets which secure an EDA fixed asset loan or guarantee (13 CFR 306.8(c)) Source: *bank denial letters, etc.* Location: *Tab A*	*Yes*
4. Loan for which guarantee is sought will be used for the following purposes only: (§254(b): 13 CFR 315.24(b))	
(a) the acquisition, construction, installation, modernization, development, conversion, or expansion of land, plant, buildings, equipment, facilities, or machinery ☒	*Yes*
(b) to supply such working capital as may be necessary to enable the	

	Requirement Satisfied
firm to implement its adjustment proposal ☒ Source: *guaranty agreements* Location: *file*	*Yes*
5. EDA determines that the funds required are not available from the firm's own resources (§255(a)(1); 13 CFR 315.25(a)) Source: *ED506* Location: *file*	*Yes*
6. EDA determines that there is a reasonable assurance of repayment of the loan for which guarantee is sought (§255(a)(2); 13 CFR 315.25(a)(c)) Source: *ED506* Location: *file*	*Yes*
7. The total amount of loans guaranteed under the authority of the Trade Act for this firm does not exceed $3,000,000; this includes the amount of loan guarantees made under the Trade Expansion Act of 1962 (§255(h)(1); 13 CFR 315.28(c)) Source: *ED506* Location:	*Yes*
8. The term of the loan for which the guarantee is sought is limited to 25 years including extensions and renewals (§255(c); 13 CFR 315.28(a)) (a) this limitation does not apply to securities or obligations acquired as a claimant in bankruptcy or equitable reorganization, or as a creditor in other proceedings attendant upon insolvency of the obligor Source: *guaranty agreements* Location: *file*	*Yes*

	Requirement Satisfied
9. The rate of interest on the loan for which the guarantee is sought is no higher than the maximum interest per annum that a participating financial institution may establish on a guaranteed loan made pursuant to §7(a) of the Small Business Act; the rate is variable and may be found in the Federal Register (§255(b); 13 CFR 315.26(a)) Source: *Bulletin #5-81* Location:	*Yes*
10. The amount of the loan subject to the guarantee does not exceed 90% of the outstanding unpaid balance of the loan (§255(e); 13 CFR 315.28(b)) Source: *guaranty agreements* Location: *file*	*Yes*
11. EDA has charged a fee to the lender which makes a loan guaranteed under this subpart in an amount necessary to cover the administrative costs of the guarantee (§255(g); 13 CFR 315.30) Source: Location:	*N/A*
12. EDA will record any mortgage acquired as security for a loan under applicable State law (§257(b); 13 CFR 315.31(b)) Source: *guaranty agreements* Location: *file*	*Yes*
13. The owners, partners, or officers of the firm have certified to EDA the names of any agents engaged by or on behalf of the firm for the purpose of expediting applications for adjustment assistance	

	Requirement Satisfied
and the fees paid to such persons (§258(c); 13 CFR 315.34) Source: *ED201* Location: *file Tab A*	*Yes- None Listed*
14. The owners, partners, or officers of the firm have executed an agreement to refrain from employing for a period of two years any person who for a year prior to the grant of assistance occupied a position or engaged in activities involving descretion with respect to the grant of financial assistance (§258(d); 13 CFR 315.34) Source: Location: *file Tab A*	*Yes*
15. Recipient agrees to keep records: (§258(a)) (a) which disclose the amount and disposition of any proceeds of assistance	*Yes*
(b) which will facilitate an effective audit	*Yes*
(c) which EDA may prescribe Source: *Gen'l Terms and Conditions* Location: *attached to guar agreements*	*Yes*
16. Recipient agrees to allow access to all records pertaining to EDA assistance for purposes of audit and examination by	

	Requirement Satisfied
EDA and the Comptroller General of the United States (s258(b)) Source: *Gen'l Terms and Conditions* Location: *attached to guar agreements*	*Yes*
17. Recipient agrees to keep records: (13 CFR 309.9) (a) on the total cost of the project for which assistance is given	*Yes*
(b) on the amount and nature of that portion of the cost of the project or undertaking supplied by other sources Source: *Gen'l Terms and Conditions* Location: *guar agreements*	*Yes*
18. Name check information has been obtained Source: Location: *pending*	*Pending*
19. Physically Handicapped Persons (13 CFR 309.14) (a) where assistance is used to construct a facility, recipient provides ready access to and use of such building by the physically handicapped	*N/A*
(b) construction or alteration of facility meets minimum standards applicable	*N/A*
(c) this requirement is not applicable to a project under consideration because (1) the intended use of the building is such that the physically handicapped would not use it ☐	

	Requirement Satisfied
(2) alteration does not involve work on facilities susceptable to improvements to accomodate the handicapped ☐ (3) alteration of the building to comply with standards is not structurally possible ☐	*N/A*
(d) waiver or modification of standards for this project approved by the Administrator of the General Services Administration Source: Location:	*N/A*
20. Environmental Findings Complete each of the following three sections, a., b., and c.:	
(a) Approval of this project will not violate the provisions and requirements of any of the following Acts:	*Yes*
☒ National Environmental Policy Act	
☒ National Historic Preservation Act; and Procedures for the Protection of Historic and Cultural Properties developed by the Advisory Council on Historic Preservation (36 CFR, Part 800); 13 CFR 309.18; and EDA Directive No. 17.02-2	*Yes*
☒ Clean Air Act and the Federal Water Pollution Control Act requirements (EDA Directive 17.02-7)	*Yes*
☒ Wild and Scenic Rivers Act	*Yes*
(b) The following determinations have been made under Directive 17.02-7	

	Requirement Satisfied
relative to Clean Air and Water Acts (check only one):	
☐ The project does not utilize an existing facility, or the recipient does not own or is otherwise not responsible for capital improvements to any facility that might be utilized	
OR	
☒ The project utilizes an existing facility which is not on the EPA List of Violating Facilities	*Yes*
OR	
☐ The project utilizes an existing facility that is on the EPA List of Violating Facilities for one of the following two bases:	
OR	
☐ reason for listing in non-criminal violation	
OR	
☐ reason for listing is criminal conviction	*N/A*
OR	
☐ The project utilizes an existing facility that is not listed on the EPA List (or its listing is for a non-criminal violation) and is exempt from the requirements of EDA Directive 17.02-7 for one of the following two reasons:	
☐ total Federal participation in the project does not exceed $100,000	*N/A*
OR	
☐ the principal purpose of the project is to assist a facility in complying	

	Requirement Satisfied
with Federal, State, or local pollution laws	*N/A*
OR	
☐ the Project utilizes an existing facility that is exempt from the requirements of EDA Directive 17.02-7, based on the Assistant Secretary's discretionary powers, and the exemption contains the following three elements:	
OR	*N/A*
☐ Exemption does not exceed one year	
AND	
☐ Exemption specifies parties to which it applies	
AND	
☐ Exemption specifies terms on which it granted	
☒ The project utilizes an existing facility that is not included on the EPA List of Violating Facilities and that is not exempt from the requirements of EDA Directive 17.02-7; therefore, the applicant has completed Form ED-524, Certificate of Compliance	
(c) Clean Air and Water clauses are included in one of the following:	
☐ Special Terms and Conditions	
OR	
☐ General Terms and Conditions	
OR	
☐ Amendment Letter	*Yes*

	Requirement Satisfied
Source: *ED201 General Terms and Conditions Environmental Reviews* Location: *file Tab A guaranty agreement file Tab G*	
21. It has been determined that the project does not involve undue risk of flood damage, as required by Executive Order 11296, issued August 10, 1966 (13 CFR 309.15)	*Yes*
Source: *Environ. Review* Location: *file Tab G*	
22. Flood Hazard Insurance (applicable in all projects where assistance is for acquisition or construction purposes) (13 CFR 309.15)	
(a) the facility is located in a HUD identified special flood hazard area, the community is participating in the National Flood Insurance Program, and the applicant will purchase such flood hazard insurance as is required in the Standard Terms and Conditions	*N/A*
(b) Flood insurance under the Flood Disaster Protection Act of 1973 is not required for one of the following reasons:	
(1) the facility is not located in the community which HUD has identified as containing one or more special flood hazzard areas ☐	*N/A*
(2) the project consists wholly of elements uninsurable under the National Flood Insurance Program ☐	

	Requirement Satisfied
(3)the community in which the project will be located was formally identified by HUD as having one or more special flood hazard areas on _____. The community is not now participating in the National Flood Insurance Program, but flood insurance is not required because one year has not elapsed since formal identification ☐	*N/A*
(4)the facility is located in a community HUD has identified as having one or more specific flood hazard areas, but the specific location of the project within such community is outside a special flood hazard area ☒	*Yes*
(5)the facility is located in a HUD identified special flood hazard area but all construction involved or all personal property acquired will be at an elevation above the base flood level ☐	*N/A*
Source: *Environ. Review* Location: *Tab G*	

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WISCONSIN

CITIZENS MARINE NATIONAL BANK, formerly the Citizens National Bank of Stevens Point,

Plaintiff,

v.

WEBER TACKLE COMPANY, a Wisconsin corporation, and WEBER PLASTICS, INC., a Wisconsin corporation, UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, MALCOLM BALDRIDGE, in his official capacity as Secretary of Commerce, or his Successor, UNITED STATES OF AMERICA, REMER HUTCHINSON and ELAINE HUTCHINSON,

Defendants.

MEMORANDUM AND ORDER

85-C-637-S

Plaintiff Citizens Marine National Bank participated in an Economic Development Administration (EDA) program to create and implement a recovery plan for Weber Tackle Company and Weber Plastics, Inc. Pursuant to that program, Citizens loaned Weber $2,100,000, which was guaranteed by the EDA and Remer and Elaine Hutchinson. Weber failed to repay the loans, and Citizens brought this action against the EDA and the Hutchinsons in an attempt to collect on the guaranties. The Hutchinsons filed a counterclaim against Citizens and a cross-claim against the EDA.

Plaintiff has moved for summary judgment on its claim against Remer and Elaine Hutchinson. Summary judgment is appropriate when, after both parties have had the opportunity to submit evidence in support of their respective positions and the Court has viewed such evidence in the light most favorable to the non-movant, there remains no genuine issue of material fact in the case. *Celotex Corp. v Catrett,* 106 S.Ct. 2548, 2552-53 (1986).

After the Court examines plaintiff's motion for summary judgment, the Court will examine whether summary judgment should be granted in favor of the EDA on the Hutchinsons' cross-claim.

FACTS

The following facts are the facts viewed in the light most favorable to the defendants Remer and Elaine Hutchinson.

In the late summer of 1979, Remer Hutchinson began negotiations for the purchase of Weber Tackle Company. These negotiations took place principally with Kenneth M. Schmidt, Vice-President of Citizens.

On October 15, 1979, Hutchinson entered into a Stock Purchase Agreement wherein he purchased 65.5% of the outstanding stock of Weber Tackle Company, a Wisconsin corporation. Weber Tackle Company owned all of the stock of Weber Plastics, Inc. Hutchinson invested a total of $216,304.07 of his personal funds in Weber Tackle. Of the $216.304.07 invested, $16,500.00 was repaid with the Bank's permission, and the balance owed by Weber Tackle to the Hutchinsons is $199,804.07.

Weber Tackle, in conjunction with the Bank, applied for a $2,100,000 loan guaranty from the Economic Development Administration of the United States Government. The loan guaranty request was approved and the loan closing took place on December 17, 1981.

In conjunction with that loan closing, Remer and Elaine Hutchinson signed a personal guaranty of the corporate obligation. This guaranty provided that Remer and Elaine Hutchinson jointly and severally unconditionally guaranteed to Citizens (a) the full and prompt payment of the principal and premium of any Note issued pursuant to the Loan Agreement when due, (b) the full and prompt payment of any interest on any Notes issued pursuant to the Loan Agreement when due; and (c) the full and prompt payment of any and all charges and expenses of Citizens required to be paid by Weber under the Loan Agreement, the Notes and the Mortgage. That guaranty further provided, in pertinent part, as follows:

> SECTION 3.3. Notwithstanding anything contained herein to the contrary, the bank agrees not to enforce this guaranty by attachment, levy of execution, or any other legal proceeding against the real property interest of Remer Hutchinson in his primary personal residence during the term of this guaranty so long as the same consists of twenty acres or less land and not more than seventy-five thousand dollars of the guarantor's personal property (whether owned singly, jointly, in common, or ownership in any other form).

In addition, Hutchinson and Citizens signed a Letter Agreement. In pertinent part, that Letter Agreement provides as follows:

> This letter is intended to clarify certain matters relating to the Financing Agreement (the "Financing Agreement"), the Loan Agreement (the "Loan Agreement") and the Standby Agreement (the "Standby Agreement") between Weber Tackle Company and Weber Plastics Incorporated (collectively, the "Borrower"), Remer Hutchinson (the "Standby Creditor")

and the Citizens National Bank of Stevens Point (the "Bank") of even date herewith, setting forth the terms and conditions upon which the Bank has agreed to make loans to Borrower in the aggregate amount of $2,100,000, 90% of the principal amount of which is to be guaranteed by the United States Department of Commerce, Economic Development Administration (the "EDA").

* * *

Notwithstanding anything to the contrary in the Standby Agreement or any other agreement between the Standby Creditor and/or Borrower and the Bank, upon payment in full on the Notes evidencing the EDA guaranteed loans to be made under the Loan Agreement (the "Notes") the Standby Creditor shall be entitled to receive payment of his Claims (as defined in the Standby Agreement) to the extent the aggregate amount of such Claims exceeds $50,000 in principal amount, prior to payment of any other claims or indebtedness owing by the Borrower to the Bank or its successors and assigns.

* * *

In the event that collateral held by the Bank is sold or any judicial or non-judicial insolvency proceeding shall be commenced by or against the Borrower (including, without limitation, any bankruptcy, plan of arrangement, reorganization, receivership or assignment for the benefit of recitors), or in the event of any liquidation of the borrower's assets, whether voluntary or involuntary, the Bank will pay or cause to be paid to the Standby Creditor any and all dividends or other payments which the Bank may receive or be entitled to receive on any Junior

> Indebtedness in connection with any such dispostion of collateral or any such insolvency proceeding or liquidation, until the amount by which the Claims (excluding accrued interest) exceed $50,000 has been paid to the Standby Creditor in full. The Bank hereby irrevocably assigns to the Standby Creditor any and all claims which the Bank may have with respect to any Junior Indebtedness in connection with any such insolvency proceeding or liquidation, and hereby directs the Borrower, and any trustee in bankruptcy, receiver, court, assignee or liquidating agent to pay to the Standby Creditor any and all dividends or other payments payable with respect to any Junior Indebtedness in connection with such insolvency proceeding or liquidation, until the amount by which the Claims (excluding accrued interest) exceed $50,000 shall be paid in full to the Standby Creditor.

Weber defaulted on the Loan Agreement and notes and mortgages issued pursuant to the Loan Agreement by failing to make the payments required thereunder subsequent to October 18, 1982.

OPINION

Plaintiff contends that it is entitled to summary judgment against the Hutchinsons because there is no dispute as to any material fact necessary to prove its case. Plaintiff points to the fact that there is no dispute that Remer and Elaine Hutchinson executed the guaranty for the loan to Weber Tackle, and that Weber Tackle subsequently defaulted on that loan.

Defendants Remer and Elaine Hutchinson admit that they are liable on their guaranty, but contend that a genuine issue of material fact exists as to the amount of their liability. Defendants contend there is a genuine

issue because the language in the Guaranty Agreement and the Letter Agreement regarding the extent of the Hutchinsons' liability is conflicting and therefore ambiguous. This contention was made by the Hutchinsons in their counterclaim against the plaintiff.

The Hutchinsons make the following argument in their brief.

> In the Guaranty Agreement, Hutchinson agrees to guaranty in full the $2,100,000.00 EDA loan. The Guaranty Agreement provides that this agreement cannot be enforced against his personal residence, nor against the first $75,000.00 of personal property which he owns either singly or jointly. On the other hand, the Letter Agreement signed by the same parties which specifically makes reference to the EDA loan and the various documents signed as part of that loan agreement and provides that the Letter Agreement shall control "notwithstanding anything to the contrary in the Standby Agreement or any other agreement between the standby creditor and/or borrower and the bank" assures Hutchinson that he will be in a priority position to receive back those personal funds invested in the corporation above a $50,000.00 floor. The obvious inconsistency and ambiguity related to why Hutchinson would seek to receive back his investment (approximately $150,000.00) if only $75,000.00 of that sum would be protected from garnishment or enforcement of the guaranty obligation.

After examining defendants' argument, this Court is of the opinion that the defendants' perceived ambiguity is nonexistent. The terms of the Guaranty Agreement and the Letter Agreement do not conflict at all. The EDA loan must be paid first and the Hutchinsons have

guaranteed that loan, although the guaranty cannot be enforced against the Hutchinsons' personal residence "so long as the same consists of twenty acres or less land and not more than seventy-five thousand dollars of the guarantor's personal property." Once the EDA loan is paid, the Letter Agreement takes effect. Not until the EDA loan is paid and the Letter Agreement takes effect are the Hutchinsons entitled to receive payment of their claims to the extent that the aggregate amount of their claims exceeds $50,000 in principal amount, prior to the payment of any other claims.

For these reasons, the Court finds that the Guaranty Agreement between Citizens and the Hutchinsons is not ambiguous. The Guaranty Agreement clearly provides that the Hutchinsons have guaranteed the EDA loan in full. Citizens, however, is prohibited from enforcing this guaranty against the Hutchinson's personal residence so long as the residence consists of twenty or less acres of land and not more than $75,000 of personal property. Since the Court finds that the Guaranty Agreement signed by the Hutchinsons is not ambiguous, there is no genuine issue of material fact with regard to the amount of the Hutchinsons' liability. Given that there are no genuine issues of material fact with regard to Citizen's claim against the Hutchinsons or to the Hutchinsons' counterclaim against Citizens, summary judgment on Citizen's claim against the Hutchinsons and on the Hutchinsons' counterclaim against Citizens will be granted in favor of the plaintiff.

The Court now will examine whether summary judgment should be granted in favor of the EDA on the Hutchinsons' cross-claim. The Hutchinsons alleged that Citizens agreed to subordinate its priority position to the Hutchinsons' personal claim for money advanced to Weber in excess of $50,000. In their cross-claim, Hutchinsons claim that the EDA was aware of Citizen's agreement and agreed to subordinate its interest to the

Hutchinsons.

The Court, however, believes that the unambiguous language of the contracts clearly provides that the EDA's interest in the repayment of the EDA loan is not subordinate to the Hutchinsons' personal claim for money advanced to Weber in excess of $50,000. The priority given to the Hutchinsons' personal claim for money advanced to Weber in excess of $50,000 arose from the Letter Agreement and a prior agreement between Citizens and the Hutchinsons. These agreements, however, do not take effect until the EDA loan is paid. Therefore, it is clear that the EDA's interest in the repayment of the EDA loan must be satisfied before the Hutchinsons can claim priority for their personal claim for money advanced to Weber in excess of $50,000.

For these reasons, the Court finds that there is no genuine issue of material fact with regard to the claim that the EDA's interest in the repayment of the EDA loan is subordinate to the Hutchinsons' personal claim for money advanced to Weber in excess of $50,000. Accordingly, the Court holds that summary judgment should be granted in favor of the EDA on the Hutchinsons' cross-claims.

ORDER

IT IS ORDERED that plaintiff's motion for summary judgment on its claim against the Hutchinsons is GRANTED in the amount of $1,949.383.00, together with interest at the contract rate until the entry of judgment.

IT IS FURTHER ORDERED that summary judgment is GRANTED in favor of the plaintiffs on the Hutchinsons' counterclaim.

IT IS FURTHER ORDERED that summary judgment is GRANTED in favor of the EDA on the Hutchinsons' cross-claim.

Entered this 4th day of August, 1987.

BY THE COURT:

/s/ John C. Shabaz
JOHN C. SHABAZ
District Judge

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WISCONSIN

CITIZENS MARINE NATIONAL BANK,
Plaintiff,

v.

85-C-637S

WEBER TACKLE COMPANY, et al.,
Defendants.

JUDGMENT

Plaintiff's motion for summary judgment against the Hutchinson defendants was fully briefed and came to hearing before the Court with the Honorable John C. Shabaz presiding. The issues have been heard and a decision has been rendered. Pursuant to the Court's Orders dated August 4, 1987 and September 18, 1987, and the Order for Judgment filed herewith,

IT IS ORDERED AND ADJUDGED that summary judgment is granted in favor of the plaintiff and against the Hutchinson defendants on their personal guaranty in the amount of $3,101,141.65, principal and interest through August 4, 1987, together with interest at the contract rate until the entry of judgment, with interest on the total amount at the legal rate thereafter, and costs;

IT IS FURTHER ORDERED AND ADJUDGED that summary judgment is granted in favor of the plaintiff dismissing the Hutchinson defendants' counterclaim with prejudice and with costs; and

IT IS FURTHER ORDERED AND ADJUDGED that summary judgment is granted in favor of the EDA dismissing the Hutchinson defendants' cross-claim with prejudice and with costs.

With respect to the judgment against the Hutchinson defendants, the Court has, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, expressly directed the entry of judgment and has further expressly determined that there is no just reason for delay.

This action also came to trial before the Court on August 13, 1987 with the Honorable John C. Shabaz presiding. The plaintiff and the governmental defendants appeared and presented evidence on the plaintiff's claims against the governmental defendants. The issues have been tried and a decision has been rendered. Pursuant to the Court's Orders dated August 18, 1987 and September 18, 1987, the judgment previously entered against the governmental defendants on August 19, 1987, and also the Order for Judgment filed herewith.

IT IS ORDERED AND ADJUDGED that the judgment previously entered against the federal defendants on August 19, 1987 is incorporated herein as though set forth in full;

IT IS FURTHER ORDERED AND ADJUDGED that judgment has been granted in favor of the plaintiff and against the defendants United States Department of Commerce, Economic Development Administration, Malcolm Baldridge, in his official capacity as Secretary of Commerce, or his successor, and the United States of America, in the amount of $2,795,523.31, together with interest thereon from August 13, 1987, and costs;

IT IS FURTHER ORDERED AND ADJUDGED that judgment be entered in favor of the plaintiff and against the defendants United States Department of Commerce, Economic Development Administration, Malcolm Baldridge, in his official capacity as Secretary of Commerce or his successor, and the United States of America, for all reasonable expenses for the care, preservation, maintenance and liquidation of the collateral

securing the Weber Tackle Company loans to the extent of the EDA's interests in those loans, including attorneys fees. The liquidation and foreclosure expenses will continue to accrue until the liquidation and foreclosure process has been completed through payment of the judgment by the governmental defendants or otherwise, and the exact amount of such expenses and the governmental defendants' obligation therefor may be established or proven up at the conclusion of the liquidation process.

With respect to the judgment against the governmental defendants, the Court has, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, expressly directed the entry of judgment and has further expressly determined that there is no just reason for delay.

Entered and docketed this 8th day of October 1987.

Clerk of the District Court

/s/ JOSEPH W. SKUPNIEWITZ

JUDGEMENT — ORAL ARGUMENT

United States Court of Appeals

For the Seventh Circuit

Chicago, Illinois 60604

August 8, 1988.

Before

Hon. HARLINGTON WOOD, JR., Circuit Judge
Hon. RICHARD A. POSNER, Circuit Judge
Hon. JESSE E. ESCHBACH, Senior Circuit Judge

CITIZENS MARINE NATIONAL BANK, formerly the CITIZENS NATIONAL BANK OF STEVENS POINT,
Plaintiff-Appellee,

Nos. 87-2705, 87-2789 *vs.*

UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, MALCOLM BALDRIDGE, in his official capacity as Secretary of Commerce, UNITED STATES OF AMERICA, REMER HUTCHINSON, and ELAINE HUTCHINSON,
Defendants-Appellants.

Appeals from the United States District Court for the Western District of Wisconsin.

No. 85 C 637

John C. Shabaz, Judge

This cause was heard on the record from the United States District Court for the Western District of Wisconsin, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment for Citizens against Hutchinsons is VACATED with directions to

dismiss the bank's complaint against them for lack of federal jurisdiction, and the judgment for Citizens against the federal defendants is REVERSED with directions to dismiss its claim against them on the merits with no award of costs in this Court, in accordance with the opinion of this Court filed this date.

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604

September 9, 1988

Before

Hon. HARLINGTON WOOD, JR., Circuit Judge
Hon. RICHARD A. POSNER, Circuit Judge
Hon. JESSE E. ESCHBACH, Senior Circuit Judge

CITIZENS MARINE NATIONAL BANK, formerly the CITIZENS NATIONAL BANK OF STEVENS POINT,
Plaintiff-Appellee,

No.s. 87-2705, 87-2789 *vs.*

UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, C. WILLIAM VERITY in his official capacity as Secretary of Commerce, UNITED STATES OF AMERICA, REMER HUTCHINSON, and ELAINE HUTCHINSON,
Defendants-Appellants.

Appeals from the United States District Court for the Western District of Wisconsin.

No. 85 C 637

John C. Shabaz, Judge.

ORDER

On August 22, 1988, plaintiff-appellee filed a petition for rehearing with suggestion for rehearing en banc. All of the judges on the original panel have voted to deny the petition, and none of the active members of the court has requested a vote on the suggestion for rehearing en banc. The petition is therefore DENIED.

STATUTORY PROVISIONS INVOLVED

19 U.S.C. § 2342. Approval of adjustment proposals

(b) Technical and financial assistance

(1) Adjustment assistance under this part consists of technical assistance and financial assistance, which may be furnished singly or in combination. The Secretary shall approve a firm's application for adjustment assistance only if he determines--

(A)that the firm has no reasonable access to financing through the private capital market, and

(B) that the firm's adjustment proposal–

(i) is reasonably calculated materially to contribute to the economic adjustment of the firm,

(ii) gives adequate consideration to the interests of the workers of such firm, and

(iii) demonstrates that the firm will make all reasonable efforts to use its own resources for economic development.

(2) The Secretary shall make a determination as soon as possible after the date on which an application is filed under this section, but in no event later that 60 days after such date.

19 U.S.C. § 2344. Financial assistance

(a) Direct loans and guarantees of loans

The Secretary may provide to a firm, on such terms and conditions as he determines to be appropriate, such financial assistance in the form of direct loans or guarantees of loans as in his judgment will materially contribute to the economic adjustment of the firm. The assumption of an outstanding indebtedness of the firm, with or without recourse, shall be considered to be the making of a loan for purposes of this section.

19 U.S.C. § 2345. Conditions for financial assistance

(a) Unavailability of firm's resources; reasonable assurance of repayment

No financial assistance shall be provided under this part unless the Secretary determines–

(1) that the funds required are not available from the firm's own resources; and

(2) that there is reasonable assurance of repayment of the loan.

(e) Loan guarantee conditions

The following conditions apply with respect to any loan guaranteed under this part:

(1) No guarantee may be made for an amount which exceeds 90 percent of the outstanding balance of the unpaid principal and interest on the loan.

(2) The loan may be evidenced by multiple obligations for the guaranteed and nonguaranteed portions of the loan.

(3) The guarantee agreement shall be conclusive evidence of the eligiblility of any obligation guaranteed thereunder for such guarantee, and the validity of any guarantee agreement shall be incontestable, except for fraud or misrepresentation by the holder.

19 U.S.C. § 2347. Administration of financial assistance

(a) Powers of Secretary

In making and administering guarantees and loans under section 2344 of this title;
the Secretary may–

(5) exercise all such other powers and take all such other acts as may be necessary or incidental to the

carrying out of functions pursuant to section 2344 of this title.

19 U.S.C. § 2350. Civil actions

In providing technical and financial assistance under this part the Secretary may sue and be sued in any court of record of a State having general jurisdiction or in any United States district court, and jurisdiction is conferred upon such district court to determine such controversies without regard to the amount in controversy; but no attachment, injunction, garnishment, or other similar process, mesne or final, shall be issued against him or his property. Nothing in this section shall be construed to except the activities pursuant to sections 2343 and 2344 of this title from the application of sections 516, 547, and 2679, of title 28.

LIST OF FEDERAL DIRECT AND GUARANTY LOAN PROGRAMS*

Direct Loan Programs:

1. Foreign military sales credit
2. Overseas Private Investment subsidies
3. Overseas Private Investment Corp
4. AID, Private sector loan subsidies
5. AID, Private sector revolving fund
6. Agricultural credit insurance subsidies
7. Agricultural credit insurance fund
8. Rural housing programs (FmHA)
9. Rural development insurance subsidies
10. Rural development insurance fund (FmHA)
11. Rural electrification and telephone revolving fund
12. Rural telephone bank subsidies
13. Rural telephone bank
14. Education
15. PMA, Bonneville fund
16. Health resources and services
17. FHA loan subsidies
18. FHA fund
19. Housing for elderly or handicapped subsidies
20. Housing for elderly or handicapped
21. Nonprofit sponsor assistance

---

* This information is taken from: U.S. Office of Management and Budget, SPECIAL ANALYSES: BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 1989; SPECIAL ANALYSIS F: FEDERAL CREDIT PROGRAMS, F-1-F-94 (1988).

22. Nonprofit sponsor assistance subsidies
23. Bureau of Reclamation, Loan program
24. Bureau of Indian Affairs
25. Highways and mass transportation
26. VA, Income security
27. VA, Mortgage insurance and other housing
28. Export-Import Bank subsidies
29. Export-Import Bank
30. SBA, Business loan and investment fund
31. SBA, Disaster loan fund
32. National Credit Union Administration, Central liquidity fund

Guaranteed Loan Programs:

1. Overseas Private Investment Corporation subsidies
2. Overseas Private Investment Corp.
3. AID private sector loan subsidies
4. AID housing and other loan subsidies
5. AID housing and other guarantee programs
6. Agricultural credit insurance subsidies
7. Agricultural credit insurance fund
8. Rural development insurance subsidies
9. Rural development insurance fund (FmHA)
10. Rural electrification and telephone subsidies
11. Economic development assistance
12. Health education assistance subsidies
13. FHA loan subsidies
14. FHA fund
15. Community development and other
16. Bureau of Indian Affairs
17. Export-Import Bank subsidies
18. Export-Import Bank
19. SBA, Business loan subsidies
20. SBA, Business loan and investment fund
21. GNMA, Guarantees of mortgage-backed securities

22. GNMA, Guarantees of mortgage-backed securities subsidies

Government Sponsored Enterprises:

1. The Farm Credit System Financial Assistance Corporation (FCSFAS)
2. The Federal Agricultural Mortgage Corporation (FAMC)
3. The Farm Credit System Insurance Corporation (FCIS)
4. The Federal Home Loan Banks
5. The Federal Home Loan Mortgage Corporation
6. The Federal National Mortgage Association
7. The Financing Corporation
8. The Student Loan Marketing Association (SMLA or Sallie Mae)
9. The College Construction Loan Insurance Association (CCLIA or Connie Lee)
10. The Federal Deposit Insurance Corporation (FDIC)
11. The Federal Savings and Loan Corporation (FSLIC)
12. The National Credit Union Administration (NCUA)

PLAINTIFF'S EXHIBIT 7

SEP 18 1981

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Economic Development
Washington, D.C. 20230

MEMORANDUM FOR: Edward G. Jeep
Regional Director
Chicago Regional Office

FROM: /s/ H.W. WILLIAMS
H.W. Williams
Acting Assistant Secretary
for Economic Development

SUBJECT: Weber Tackle Company
Stevens Point, Wisconsin

Guaranteed Fixed Asset Loan
and
Guaranteed Working Capital
Loan to be made by:
Citizens National Bank
Stevens Point, Wisconsin
Project Nos.: 06-44-00034-10
06-44-00035-20

I have this day approved your recommendation to me on the subject project and the Guaranty Agreements for the EDA Guaranteed Fixed Asset Loan and Guaranteed Working Capital Loan to be made by Citizens National Bank of Stevens Point, Wisconsin to Weber Tackle Company.

Attached are copies of the approved recommendation and Guaranty Agreements, and also copies of letters to the Lender and Borrower informing them of our action.

Under authority delegated to you, you are requested to take steps to close and approve disbursement of the guaranteed working capital loan and the guaranteed fixed asset loan in accordance with the terms and conditions of the Guaranty Agreements.

EDA-DFP

cc: File Polivka
Attachments Chron Exec. Sec.
Signer EDR
Reg. Dir. CongrLiaison
CBDD ISSD
Wells Writer
Pending Chron Sullivan/Jones

KHuth:mb 3/10/81

EDA Project Nos.: 06-44-00035-20 and 06-44-00034-10

RECOMMENDATION:

The Business Development Division of the Chicago Regional Office recommends that EDA offer a 90% guaranty of a $1,210,500 working capital loan and a 90% guaranty of a $889,500 fixed asset loan, to be made to Weber Tackle Company by Citizens National Bank subject to the terms and conditions of the accompanying Guaranty Agreements.

APPROVED: /s/ H.W. WILLIAMS

DISAPPROVED: _____

DATE: 9/16/81

PLAINTIFF'S EXHIBIT 9

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Economic Development
Washington, D.C. 20230

SEP 18 1981

Mr. Kenneth M. Schmidt
Vice-President
Citizens National Bank
Post Office Box A
Stevens Point, Wisconsin 54481

Re: EDA Project Nos.: 06-44-00034-10
06-44-00035-20

Dear Mr. Schmidt:

The Economic Development Administration (EDA) has approved the application for a trade adjustment assistance 90% guaranty of a $1,210,500 working capital loan (Project No. 06-44-00035-20) and 90% guaranty of a $889,500 fixed asset loan (Project No. 06-44-00034-10) to Weber Tackle Company, Stevens Point, Wisconsin. The loans are to be made on terms and conditions substantially similar to those set forth in the application.

Enclosed are three signed copies of EDA's offer to guarantee said loans. If the terms and conditions of the Guaranty Agreements are acceptable, please execute and return one copy of each Agreement to Alejandro Vallecillo, Chief, Project Review Division, Office of Development Finance Projects, EDA, Room 7880, Main Commerce, Washington, D.C. 20230. The second set of copies should be executed and returned to Edward G. Jeep, Regional Director, Chicago Regional Office, EDA, 175 West Jackson Boulevard, Suite A-1630, Chicago, Illinois

60604. The third set of copies is for your files as evidence of the extent of the obligations of the parties with respect to the guaranties. When the loans have been closed, please provide EDA with two copies of the executed loan instruments and other closing documents.

These guaranties will be serviced by our Chicago Regional Office. Future communications should be addressed to the Regional Director. In addition, you should also be in contact with Kathryn Huth, Financial Analyst, Business Development Division, Chicago Regional Office. Her telephone number is (312) 353-9536

Sincerely,

/s/ H.W. WILLIAMS
Acting Assistant Secretary
for Economic Development

Enclosures

EDA-DFP

cc:	File	Polivka
	Chron	Exec. Sec.
	Signer	EDR
	Reg. Dir.	CongrLiaison
	CBDD	ISSD
	Wells	Writer
	Pending Chron	Sullivan/Jones

KHuth:mb 3/10/81

PLAINTIFF'S EXHIBIT 51

Citizens **NATIONAL BANK**

34481

December 7, 1981

DEC 10 '81

Ms. Kathryn Huth, Financial Analyst
U.S. Department of Commerce
Economic Development Administration
175 West Jackson Blvd., Suite A-1630
Chicago, IL 60604

RE: Weber Tackle Company

Dear Ms. Huth:

Enclosed are copies of various documents relative to our pending loan guaranty for Weber Tackle Company. Per your request, the following items are included:

1. Financial statement for fiscal year ending July 31, 1981
2. Interim statement for October 31, 1981.
3. Agreements with unsecured creditors.
4. SBA document amending the terms of our existing note.
5. Title search as of December 7, 1981.

Other documents will follow as they are prepared.

Your very truly,

/s/ KEN SCHMIDT
Kenneth M. Schmidt
Vice President

KMS:ceh

Enclosures

K. Huth

PLAINTIFF'S EXHIBIT 68

CAVANAUGH, LIGMAN & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS
1025 CLARK STREET
STEVENS POINT, WISCONSIN 54481

(715) 341-3232

THOMAS F. CAVANAUGH, C.P.A.
RONALD A. LIGMAN, C.P.A.
ELROY ZOCHER, C.P.A.

December 10, 1981

Ms. Catherine Huth
Office of Economic Development Administration
Midwest Region
175 Jackson Blvd.
Suite A 1630
Chicago, Illinois 60604

Dear Ms. Huth:

Our firm issued an audit report, dated November 13, 1981, on the consolidated financial statements of Weber Tackle Company and its wholly-owned subsidiary, Weber Plastics, Inc. These financial statements were prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the previous year.

Although the statements were prepared in conformity with generally accepted accounting principles, we were required to qualify our opinion because of the uncertainty of the Company's ability to increase its sales volume in accordance with its recovery plan, which the Company must do to remain a viable entity.

If you need additional information, please feel free to contact us at any time.

Sincerely,

/s/ FRED CARUSO
Fred Caruso, C.P.A.

ss

PLAINTIFF'S EXHIBIT 14

U.S. DEPARTMENT OF COMMERCE
Economic Development Administration
MIDWESTERN REGIONAL OFFICE
175 WEST JACKSON BOULEVARD, SUITE A-1630
CHICAGO, ILLINOIS 60604

December 17, 1981

Citizens National Bank
Post Office Box A
Stevens Point, Wisconsin 54481

Re: EDA Guaranty of Loans Made to
Weber Tackle Company
EDA Porject Nos. 06-44-00034-10
and 06-44-00035-20

Dear Sir or Madam:

After having reviewed the closing documents and the opinions of Lender's and Borrower's Counsel, I find that all conditions precedent and requirements to the closing and disbursement of the Guaranteed Loans, as contained in the Guaranty Agreements by the EDA of the Guaranteed Loans and General Terms and Conditions attached thereto, have been met and the Guaranty is in full force and effect.

Furthermore, since the date of the acceptance of the Guaranty Agreements by Citizens National Bank, there have been no unremedied adverse changes in the financial condition of Weber Tackle Company sufficiently serious, in my opinion, to warrant withholding disbursement on account of the referenced loans. My opinion in this regard is based on the affidavit and statements of Remer Hutchinson, President and Treasurer of Weber Tackle Company.
Sincerely,

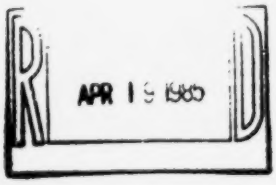
/s/ EDWARD G. JEEP
Edward G. Jeep
Regional Director

PLAINTIFF'S EXHIBIT 193

UNITED STATES DEPARTMENT OF COMMERCE
Economic Development Administration
Washington, D.C. 20230

APR 17 1985

Mr. Kenneth M. Schmidt
Vice President
Citizens National Bank
Stevens Point, Wisconsin 54481



Re: Weber Tackle Company

Dear Mr. Schmidt:

This is in response to your letters of March 19, April 3, April 5, 1985, and your demand for EDA to honor its guarantee of the above-referenced loan from your bank.

We are now prepared to make a final determination regarding such payment and are forwarding herewith the following documents intended for execution at or prior to closing, for your review:

- Subordination Agreement
- Lender's certification to Guarantor

Also enclosed is an information copy of a letter from Walter McLellan to your attorney regarding his opinion letter.

To compute the amount due from EDA to Citizens National Bank, we ask that you furnish, a history of the interest accruals posted to the respective accounts. This in addition to the transcripts sent previously and should show the interest rate used by period. These transcripts should also be certified showing that interest computations were in accordance with EDA's provisions, i.e. not more than 2 points above prime nor exceeding 16%. In regard to your suggestion that SBA handle the

liquidation of SBA/EDA interests, we feel that the idea has merit. Therefore, would like to discuss it further with you and SBA.

In order to conclude this matter, we recommend the following steps:

1) Joseph Rusciano meet with you, the borrower, and SBA to determine first-hand our options for conducting the liquidation.

2) Citizens National Bank furnish the information requested herein and inform us regarding the documents submitted for your review.

3) That we schedule a closing in our Washington office regarding the purchase of 90% of the loans and finalization of a strategy for conducting a liquidation of the account.

Sincerely,

/s/ MICHAEL OBERLITNER
Michael Oberlitner
Acting Director
Office of Liquidation

Enclosures

No. 88-940

(3)

FILED
FEB 17 1989
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1988

BANK ONE, STEVENS POINT, NA, PETITIONER

v.

UNITED STATES DEPARTMENT OF COMMERCE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

WILLIAM C. BRYSON
Acting Solicitor General
JOHN R. BOLTON
Assistant Attorney General
JOHN F. CORDES
MARY K. DOYLE
Attorneys
Department of Justice
Washington, D.C. 20530
(202) 633-2217

MICHAEL A. LEVITT
Acting General Counsel
JAMES K. WHITE
Assistant General Counsel
GEORGE E. MADEN
WALTER J. MCLELLAN
Attorneys
Department of Commerce
Washington, D.C. 20230

18 pp

QUESTION PRESENTED

Whether the government is required to honor loan guarantees made pursuant to provisions of the Trade Act of 1974, 19 U.S.C. 2341 *et seq.*, when the lending bank materially breached the terms of the loan guaranty agreements and the government neither directed nor encouraged those breaches.

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In the Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-940

BANK ONE, STEVENS POINT, NA, PETITIONER

v.

UNITED STATES DEPARTMENT OF COMMERCE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A12) is reported at 854 F.2d 223. The opinions of the district court (Pet. App. A13-A20, A61-A69) are not reported.

JURISDICTION

The judgment of the court of appeals was entered on August 8, 1988. A petition for rehearing with suggestion for rehearing *en banc* was denied on September 9, 1988. Pet. App. A75. The petition for a writ of certiorari was filed on December 7, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner, a bank in Stevens Point, Wisconsin, had for several years made loans to Weber Plastics and Weber

Tackle, Inc. (Weber or Weber Companies) that Weber did not repay. Pet. App. A1, A13. In 1979, Weber approached petitioner for new loans to finance its fishing tackle operations and plastics manufacturing facility and to purchase new and modernize existing equipment. Pet. App. A14. Because of Weber's unsatisfactory credit history and large debt, petitioner and other local banks refused to make the requested loans. *Ibid.*

In October 1980, Weber sought financial assistance in the form of a loan guaranty from the United States Department of Commerce's Economic Development Administration (EDA) pursuant to provisions of the Trade Act of 1974, 19 U.S.C. 2341 *et seq.* Pet. App. A2, A14. The Trade Act authorized the EDA to provide financial assistance to American firms hurt by imports which had "no reasonable access to financing through the private capital market," but provided a "reasonable assurance of repayment of the loan." 19 U.S.C. 2342(b)(1)(A), 2345(a)(2)[1]; see Pet. App. A2. A necessary step in the loan guaranty application process was the preparation of a "Diagnostic Analysis and Recovery Plan." Pet. App. A14. Weber presented an initial draft of the plan to the EDA and to petitioner for review. After revisions (based upon petitioner's comments) were made in the recovery plan, it was approved by EDA. Petitioner thereafter agreed to loan Weber a total of $2.1 million, 90% of which was guaranteed by EDA. Pet. App. A14-A16.

Under the terms of the guaranty agreements, petitioner agreed to certain terms and conditions, including the re-

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[1] The Trade Act was amended in 1986 to provide that "no direct loans or guarantees of loans" could be made under the adjustment assistance provisions after April 7, 1986. 19 U.S.C. 2344(d) (Supp. IV 1986). Section 2342(b) now provides for technical assistance alone. Consolidated Omnibus Budget Reconciliation Act for 1985, Pub. L. No. 99-272, Tit. XIII, § 13006(a)(1) and (b), 100 Stat. 304.

quirement that it would exercise "such care and diligence in the disbursement, servicing, collection and liquidation of the Loan as would be exercised by a reasonable and prudent commercial bank in dealing with a loan of its funds without guaranty * * *." Pet. App. A2. Each guaranty also provided that "if the bank 'failed to comply with all of the material provisions' of the agreement[,] the government could terminate the guaranty." *Ibid.*

On November 13, 1981—after the guaranty agreements were signed, but before the loans were closed—Weber's accountants issued a Financial Report for the Fiscal Year ending July 31, 1981, which showed that Weber's losses for that year were more than double the $250,000 loss projected in the recovery plan. Pet. App. A8, A87, A88. Petitioner received a copy of the report and, on December 7, 1981, forwarded it to the EDA along with other materials. Pet. App. A87.[2]

The Weber loans were closed on December 17, 1981. Pet. App. A15. On that date, the EDA's Regional Director wrote a letter to petitioner in which he opined, on the basis of an affidavit and statements made by Weber's President and Treasurer (Remer Hutchinson), that since the date of the acceptance of the guaranty agreements by the petitioner, there had been "no unremedied adverse changes in the financial condition of Weber Tackle Company sufficiently serious * * * to warrant withholding disbursement on account of the referenced loans." Pet. App. A90.

On October 18, 1982, Weber defaulted on the loans. (It later went out of business). Pet. App. A3, A16. Petitioner timely notified EDA of the default. Pet. App. A16. Later,

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[2] It was undisputed in the court of appeals that the petitioner had received the Financial Report and sent it to the EDA before the loans were closed, although the district court was uncertain about this point. See Pet. App. A17.

on June 15, 1984, petitioner demanded that EDA honor its guarantees and repurchase the EDA-guaranteed portion of the loans. *Ibid.* On February 20, 1986, after the matter had been investigated by the Inspector General of the Department of Commerce, the EDA refused to acknowledge liability on its guaranty agreements. Pet. App. A16, A43.

2. Petitioner originally brought suit against Weber in state court, seeking to foreclose on Weber's assets that had secured the loans. Pet. App. A3. Weber answered the complaint and asserted a third-party complaint against the government. *Ibid.* After the government removed the case to the United States District Court for the Western District of Wisconsin, petitioner twice amended its complaint and ultimately named as defendants, among others, the Secretary of Commerce in his official capacity,[3] Weber, and the individual respondents Remer and Elaine Hutchinson.[4] Pet. App. A3, A4, A13.

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[3] Section 2350 of Title 19 of the United States Code provides that the Secretary of Commerce may sue and be sued in United States District Court regardless of the amount in controversy. Although petitioner named other federal defendants in its suit (the United States Department of Commerce, the United States, and the EDA), it sought no separate relief against them and, as the court of appeals recognized (Pet. App. A5), they should have been dismissed. For the sake of simplicity, we will hereinafter refer to the governmental defendants collectively as the "federal respondent."

[4] Remer Hutchinson, the former president of Weber Companies, owned a controlling interest in the companies. Pet. App. A22. His wife, Elaine Hutchinson, was the former Secretary of the companies. Pet. App. A23. The individual respondents counterclaimed against petitioner, alleging that petitioner had agreed to subordinate its priority position with respect to certain collateral to their personal claim for $150,000 advanced to Weber, and filed a cross-claim against the federal respondent, alleging that it was aware of the subordination agreements, and by guaranteeing the loans, had effectively subordi-

3. The district court conducted a one-day bench trial on the loan guaranty issues. After examining those of petitioner's activities that the federal respondent claimed had breached the guaranty agreements, the court concluded that the federal respondent should not be released from its guaranty obligations. Pet. App. A13-A20.

First, the district court found that Weber's audited Financial Report for the year ended July 31, 1981 should have raised questions about the viability of the recovery plan, that both petitioner and the federal respondent should have obtained the report prior to closing the loans, and, therefore, that each entity should bear responsibility for its imprudent acts. Pet. App. A17.

Similarly, the district court was "distressed" at the petitioner's practice of allowing Weber to acquire additional fixed assets before having them approved, and of disbursing loan proceeds after Weber had defaulted. But it found the government estopped from protesting against these practices since it, too, generally followed "sloppy procedures" in approving fixed asset expenses and had not protested either that practice or the continued disbursement. Pet. App. A17-A18.

Finally, the district court found that petitioner's disbursement of the loan proceeds into a checking account controlled by a Weber company not party to the loans had been imprudent, but had caused no harm. Pet. App. A18. It held that petitioner's practice of allowing Weber to maintain substantial overdrafts and to violate certain

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nated its own interest in the collateral. Pet. App. A61-A69. Ultimately, petitioner and Weber entered into a stipulation for entry of a judgment of foreclosure and replevin against Weber. Pet. 10 n.10. Later, the district granted summary judgment for petitioner against the individual respondents, and summary judgment in favor of petitioner and the federal respondent on the individual respondents' counter- and cross-claims. Pet. 12.

negative covenants in the guaranty agreements was likewise harmless. Pet. App. A19.

4. The court of appeals reversed and directed the district court to dismiss petitioner's claim against the federal respondent on the merits. Pet. App. A11. Observing that "[t]he district judge agreed with the government that the bank had acted imprudently," the appellate court concluded that "the bank's conduct amounted to a material breach * * * which therefore excused the government from performing its obligations under the guaranty" because "the evidence overwhelmingly established that th[e] undemanding standard [for a material breach] was satisfied, and the district court's (unexplained) disagreement with this conclusion we deem clearly erroneous." Pet. App. A9-A10.

The appellate court then turned to the district court's conclusion that "the bank's imprudence was somehow cancelled by the government's." Pet. App. A10. The court of appeals held that "nothing in the guaranty agreement enjoins the guarantor to vigilance." *Ibid.* It also noted that while some subordinate EDA officials had turned a "blind eye" to some of the petitioner's imprudent acts, none of those officials had any actual or apparent authority to modify the terms of the guaranty agreements, *ibid.*, so that "[t]he failure of the Economic Development Administration's regional staff to insist upon compliance with [the provision requiring petitioner to act with the prudence of a normal commercial bank making the loan without a government guaranty] * * * does not open the vaults of the Treasury to a bank that violated the provision." Pet. App. A10-A11. Finally, although recognizing that "[t]he question whether and in what circumstances the federal government can be estopped by an act of its agents remains unsettled," the court of appeals held that petitioner's estoppel argument failed in any case because

petitioner had not demonstrated that even "the traditional elements of an estoppel" were present. Pet. App. A11.

ARGUMENT

1. Petitioner's main contention is that the court of appeals erred in failing to hold the government estopped by its own imprudent behavior from asserting petitioner's material breach of the guaranty agreements. Petitioner's objection, however, is not to any error in the legal standard adopted by the court here. While we maintained below and continue to believe that the government is not subject to estoppel in this case (see *Federal Crop Ins. Corp.* v. *Merrill,* 332 U.S. 380 (1947)), the court in fact assumed for the purposes of the decision that the government *was* susceptible to estoppel. Noting that "[t]he question whether and in what circumstances the federal government can be estopped by an act of its agents remains unsettled," the court explicitly followed the approach adopted by this Court in *Heckler* v. *Community Health Services of Crawford County, Inc.,* 467 U.S. 51, 61 (1984), to hold that " 'however heavy the burden might be when an estoppel is asserted against the Government, the private party surely cannot prevail without at least demonstrating that the traditional elements of an estoppel are present.' " Pet. App. A11. Petitioner's objection is thus simply to the application of that standard to the facts of this case, and specifically to the court's conclusion that "there was no reliance by the bank." *Ibid.*; see *Community Health Services,* 467 U.S. at 61, 66 (requiring "reasonable reliance" as element of estoppel).[5]

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[5] Petitioner's repeated attempts to distinguish cases like *Schweiker* v. *Hansen,* 450 U.S. 785 (1981); *Federal Crop Ins. Corp.* v. *Merrill,* 332 U.S. 380 (1947); *Wilber Nat'l Bank* v. *United States,* 294 U.S. 120 (1935); and *Utah Power & Light Co.* v. *United States,* 243 U.S. 389

The court of appeals' holding in this case that there was insufficient evidence to support a finding of reasonable reliance does not warrant this Court's review. Under the plain terms of the guaranty agreements, petitioner had a contractual responsibility "to administer the loan in the same fashion as would a 'reasonable and prudent commercial bank' in dealing with a loan that had not been guaranteed by the United States Government." Pet. App. A7-A8. That is, the bank was not supposed to look to the government to guide its actions. To the contrary, it was obliged by the terms of the guaranty agreements to exercise its judgment independently, guided by the practice of other commercial institutions. Petitioner does not contend that the terms of the contract were modified so as to release petitioner from its obligation to act as a "reasonable and prudent commercial bank."[6] Petitioner cannot demonstrate how it otherwise might reasonably have relied on the

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(1917), in which this Court has held estoppel against the government inappropriate, are beside the point. The court of appeals did not reach the question whether the government could be estopped on the facts of this case because it found that petitioner had failed to satisfy the traditional test for estoppel. For the same reason, petitioner's invocation of *Franchise Tax Bd.* v. *United States Postal Service*, 467 U.S. 512 (1984) and *Loeffler* v. *Frank*, No. 86-1431 (June 13, 1988) is gratuitous. *Franchise Tax Bd.* and *Loeffler* concern the obligations assumed by the Postal Service in its commercial role given a "sue and be sued" clause, and do not concern the circumstances under which such an entity might be estopped. Although petitioner cites those cases to support the proposition that when the government enters into commercial activities, its liabilities are the same as those of other private entities, the court of appeals had already assumed as much in this case when it applied the principles of estoppel to the circumstances presented here.

[6] The court of appeals' determination that the subordinate officials with whom petitioner dealt had no "authority to modify the terms of the guaranty" is germane to no wider point. See Pet. App. A10.

government; the court of appeals did not err in concluding that the district court's unexplained conclusion to the contrary was mistaken.

Petitioner observes (Pet. 20-22), as did the court of appeals (Pet. App. A11), that the law of estoppel remains unsettled. As petitioner notes (Pet. 20-22), a number of courts of appeals have held that the government may not be estopped when it acts in its sovereign capacity (see, *e.g.*, *United States* v. *Florida*, 482 F.2d 205, 210 (5th Cir. 1973); cf. *United States* v. *Mattuci*, 502 F.2d 883 (6th Cir. 1974)); other courts have held that the government may be estopped when it acts in a "proprietary" capacity as when its activities are arguably analogous to those of a private concern (see, *e.g.*, *Federal Deposit Ins. Corp.* v. *Harrison*, 735 F.2d 408, 412 (11th Cir. 1984); *Branch Banking & Trust Co.* v. *United States*, 98 F. Supp. 757 (Ct. Cl.), cert. denied, 342 U.S. 893 (1951)); still others have eschewed the sovereign/proprietary distinction, and have held that the government may be estopped only if, in addition to the traditional elements of estoppel, the government's agents have engaged in "affirmative misconduct" that causes "serious injustice" to the complainant (see, *e.g.*, *Wagner* v. *Director, Federal Emergency Management Agency*, 847 F.2d 515, 519 (9th Cir. 1988); *Morgan* v. *Heckler*, 779 F.2d 544, 545 (9th Cir. 1985)).[7]

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[7] *Maxima Corp.* v. *United States*, 847 F.2d 1549 (Fed. Cir. 1988), and *Brown* v. *Marsh*, 777 F.2d 8 (D.C. Cir. 1985), cited by petitioner (Pet. 20-21), are not relevant because they do not concern estoppel. In *Maxima Corp.*, the court held that under contract law the government could not retroactively apply a "termination for convenience" clause to a contract already fully performed on both sides. In *Brown*, the court held that a plaintiff had substantially satisfied his duty to exhaust administrative remedies, adding that, where the obligation did not have the nature of a jurisdictional bar, the government could not press the obligation as a legal defense when it had failed to raise the defense sufficiently below.

Under any of these approaches, however, the government would not have been estopped here. Petitioner failed to demonstrate even that the traditional elements of estoppel, let alone "affirmative misconduct" causing "serious injustice," existed here. Since the result in this case would not have been different in any circuit, any conflict that exists among the courts of appeals in their treatments of estoppel cases is not presented by the decision in this case.[8]

2. Petitioner also claims that the court of appeals engaged in improper factfinding. See *Icicle Seafoods, Inc.* v. *Worthington*, 475 U.S. 709, 714 (1986). Although the court of appeals arguably engaged in commentary unrelated to the issues developed before the district court and unnecessary to the disposition of the case,[9] there was no disagreement as to the key factual finding. The district court found (Pet. App. A17-A20), and the court of ap-

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[8] In a related vein, petitioner suggests (Pet. 22-23) that it might benefit by an application of "appropriate principles of guaranty law," even if it cannot demonstrate the traditional elements of an estoppel. See Pet. 22 (citing *Lyng* v. *Payne*, 476 U.S. 926, 936 (1986)). Even assuming that such an approach would be proper here, an element of the guaranty agreement at issue in this case was the requirement that the bank exercise its independent "reasonable and prudent commercial" judgment. There was no corresponding requirement placed on the federal respondent to evaluate and verify whether petitioner's actions were those of a "reasonable and prudent commercial bank." See Pet. App. A10. Nor did the government ever take such action. The petitioner failed to meet a material requirement of the guaranty; it therefore cannot seek to enforce the guaranty.

[9] For example, petitioner objects (Pet. 24 n.16) to the court of appeals' characterization of petitioner's decision to close the loans as "yield[ing] to [the] temptation" to take advantage of the government's guaranty program (Pet. App. A8). This statement, however, is simply part of the court's generic observation that a bank could be expected to close a deal if it decided that the deal worked to its commercial self-interest; it is not specifically related to the court's disposition of this case. See *Ibid.*

peals agreed (Pet. App. A10), that petitioner had acted imprudently in closing the Weber loans, and in the way it serviced those loans. This Court does not sit to review that factual finding. *Tiffany Fine Arts, Inc.* v. *United States,* 469 U.S. 310, 317-318 n.5 (1985); *Graver Tank & Mfg.* v. *Linde Air Products Co.,* 336 U.S. 271, 275 (1949).

The main disagreement between the court of appeals and the district court did not concern the finding that the petitioner had acted imprudently, but the legal consequences of that finding. Specifically, unlike the district court, the court of appeals held that the imprudence of the petitioner in closing the loans, like its subsequent imprudence in servicing the loans, violated its contractual obligation to act as a "reasonable and prudent commercial bank." Pet. App. A7-A9. It ruled that the "reasonable and prudent" requirement was a "central undertaking of the promisor." Pet. App. A9. Once that central undertaking was recognized to be at issue, and the court of appeals had determined that the district court's refusal to impute responsibility to the petitioner for the making of the loans was mistaken,[10] the conclusion that the district court had

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[10] The obligation of the bank to act as a "reasonable and prudent commercial bank" appeared in the guaranty agreements. In the court of appeals' view, the provision was susceptible to two interpretations: it could be interpreted as requiring "reasonable and prudent behavior" subsequent to the closing of each loan, or as requiring such behavior from the beginning of the transaction (including the closing of the loan as a necessary component of its later disbursement). Pet. App. A9. The court of appeals correctly noted that the petitioner waived the argument that the "reasonable and prudent" requirement did not apply to it from the beginning of the transaction by failing to make the argument below. *Ibid.* While petitioner suggests (Pet. 20 n.13) that it did raise the issue below, its argument in the cited pages goes only to the contentions that the petitioner did not act imprudently, that the government acted imprudently as well, and that a guarantor is not entitled to expect prudent action from a bank. It does not assert that it

clearly erred when it found (Pet. App. A19) that "[t]here has been no substantial and material breach of duty" by the petitioner was compelling. Pet. App. A9-A10.

3. Petitioner also seeks certiorari with respect to the court of appeals' ruling that the district court had no pendent party jurisdiction over petitioner's state law claim against the individual respondents, the Hutchinsons. The federal respondent is not affected by that ruling.[11] We note, however, that the issue raised by the petitioner does not require this Court to hold the petition pending disposition of *Finley* v. *United States,* cert. granted, No. 87-1973 (Oct. 3, 1988). Petitioner's arguments and those involved in the *Finley* case concerning the propriety of pendent party jurisdiction are based on the premise that the threshold requirements making pendent jurisdiction appropriate have been met. See *United Mine Workers* v. *Gibbs,* 383

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had no obligation to act prudently under the guaranty agreement itself. In any event, the petitioner does not ask this Court to review the court of appeals' interpretation of the particularities of the guaranty agreements employed here, an issue of little continuing importance given the amendment of the Trade Act to exclude financial assistance from the government. See 19 U.S.C. 2342(b), 2344(d) (Supp. IV 1986).

[11] The district court granted summary judgment for the federal respondent on a cross-claim filed against it by the Hutchinsons. The Hutchinsons had claimed that the federal respondent, by virtue of guaranteeing the Weber loans, had acquiesced in certain letter agreements by which the petitioner, and therefore the federal respondent, had subordinated its interest in certain collateral to that of the individual respondents. The court of appeals took no express action on the district court's ruling on this claim, but vacated its judgment disposing of petitioner's claim against the Hutchinsons and directed that it be dismissed for lack of subject matter jurisdiction. The individual respondents have not sought review of the court of appeals' decision. Rather, only the petitioner seeks to have the disposition relevant to its claim reviewed. The pendent party claim therefore does not concern the federal government.

U.S. 715, 725 (1966) (federal claim must be of sufficient substance to support subject matter jurisdiction, federal and state claims must be derived from "common nucleus of operative fact," and be such that plaintiff would ordinarily be expected to try both in one judicial proceeding). Unlike the district court in *Finley,* the court of appeals here rejected that premise. It found that it did not have to consider the propriety of pendent party jurisdiction because the petitioner had not demonstrated that its claim against the federal government and its claim against the individual respondents involved the same "common nucleus of operative facts." Pet. App. A7 (quoting *Gibbs,* 383 U.S. at 725). As the court explained, "[t]he bank's claim against [EDA] * * * concerns the terms of the guaranty agreement and the behavior of both the bank and the EDA in administering the loan. The bank's claim against the Hutchinsons involves the terms of its agreement with the Hutchinsons. There is no overlap of legally pertinent facts or legal principles." Thus, contrary to petitioner's contention that the Seventh Circuit failed to apply the *Gibbs* common nucleus test (Pet. 27), the Seventh Circuit applied the test and determined that "[t]he operative facts * * * are separate nuclei with much space between them." Pet. App. A7. Since the claim here did not meet the threshold requirement for pendent jurisdiction, this case does not raise the question of pendent party jurisdiction.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted.

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Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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REPLY IN SUPPORT OF PETITION FOR CERTIORARI

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1. The government's response does not dispute that the decisions of the circuits on when the government bears responsibility for commercial actions of its officials are all over the lot. See Br. Opp. 9. It attempts to brush the conflicts aside by inaccurately asserting that "[p]etitioner's objection, however, is not to any error in the legal standard adopted by the court here." Br. Opp. 7. That assertion, of course, is nonsense. Petitioner objects to, and seeks certiorari to review, the Seventh Circuit's holding that only by meeting all the traditional elements of an estoppel can the government, after inducing a loan, be held to honor its own guaranty. *Compare* Pet. Cert. 17-23 *with* Pet. Cert. App. A. 11.

2. Even if all the elements of common-law estoppel did have to be shown, the District Court found they were here. The bank's reliance on the government's actions was not conjectural: it was central. The bank had already declined to make this very loan, until the government stepped in to guarantee it. As the District Court explained,

> "There is no question that this is another government loan that should never have been made. . . . Citizens [Bank], as well as all other financial institutions, determined that Weber should not receive the requested funds. The government, however, became involved, and the loan which should never have been made was granted." Pet. Cert. App. A. 19-20.

See also *id.* A. 14, A. 23. The government, it is conceded, acted at all times with complete knowledge of all the facts and full participation in every circumstance of the transaction.[1] It was four years after the borrower's default—and after initially arranging to pay the guaranty, see Pet. Cert. App. A. 91-92—that the government decided to change course and instead dishonor the guaranty. As the District Court put it, "The [federal] defendants having apparently belatedly recognized their error in business acumen, have now determined that others are to blame." Pet. Cert. App. A. 20.

3. The government seeks to avoid this Court's review by embracing the Seventh Circuit's appellate finding that "there was no reliance by the bank." Br. Opp. 7. But the District Court—the only court empowered to make findings of fact—found specifically that there *was* reliance by

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[1] At trial, the government declined to call a single present or former EDA official to support its position. R. 240. The Bank introduced testimony of twelve present or former EDA employees who had participated in the approval, closing, disbursing servicing and liquidating of the loan, as well as of the EDA regional director and other officials from Washington. R. 188-91, 193-198, 200-201.

the bank—that "the [government] defendants are estopped by their own actions." Pet. Cert. App. A. 19.

For the Court of Appeals to throw out a District Court's fact-findings and, instead of remanding, substitute its own, clearly violates this Court's holding in *Icicle Seafoods, Inc.* v. *Worthington*, 475 U.S. 709 (1986). Faced with the *Icicle Seafoods* rule, the government backs off and says that

> "the court of appeals arguably engaged in commentary unrelated to the issues developed before the district court and unnecessary to the disposition of the case . . . ." Br. Opp. 10.

But what the government thus airily dismisses at page 10 of its brief as mere unnecessary "commentary" is what the government earlier relies on at page 7 as its factual basis for denying certiorari.

4. The Court of Appeals demonstrates an undisguised—perhaps merited—skepticism toward high-risk loan guaranty programs, of which there are dozens.[2] That is not a license, however, when such loans go sour, to reallocate the cost judicially onto the lenders instead of on the government which induced and said it stood behind them. The Court of Appeals created an anomalous legal standard to let the government out of an obligation, and ignored the proper allocation of fact-finding responsibility between it and the District Court. Its holding is far-reaching and is in conflict with decisions of other circuits and of this Court.

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[2] The Court of Appeals opined that "If the bank had been acting as a reasonable and prudent commercial lender, uncushioned by a federal loan guaranty, it would have reevaluated the making of the loan, in light of the collapse of Weber's relatively roseate prospects." Pet. Cert. App. A. 8. But the Bank *did* have a guaranty, as the federal program contemplated. It fully informed the federal guarantor of the borrower's worsened financial condition. Pet. Cert. App. A. 87. The guarantor chose to proceed to guarantee the loan anyway.

CONCLUSION

For the reasons stated here and in the petition, certiorari should be granted.

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